



# How States Are Improving Tax Incentives for Jobs and Growth

A national assessment of evaluation practices



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The Pew Charitable Trusts is driven by the power of knowledge to solve today's most challenging problems. Pew applies a rigorous, analytical approach to improve public policy, inform the public, and invigorate civic life.



## Overview

Tax incentives—including credits, exemptions, and deductions—are one of the primary tools that states use to try to create jobs, attract new businesses, and strengthen their economies. Incentives are also major budget commitments, collectively costing states billions of dollars a year. Given this importance, policymakers across the country increasingly are demanding high-quality information on the results of tax incentives.

In the last five years, 27 states and the District of Columbia have made progress in gathering evidence on the results of their economic development tax incentives. Ten of these states are leaders in tax incentive evaluation. They have well-designed plans for regular reviews, experience in producing quality evaluations, and a process for informing policy choices. No state met these three criteria five years ago.

The 10 states that excel—Florida, Indiana, Iowa, Maine, Maryland, Minnesota, Mississippi, Nebraska, Oklahoma, and Washington—rigorously measure the economic and fiscal impact of their programs. As a result, policymakers have realistic, reliable information on the effectiveness of incentives.

And when lawmakers have this information, they use it. Policymakers in numerous states, including Florida, Indiana, Maryland, and Washington, have made changes to incentives that were consistent with the findings or recommendations of evaluations. Changes both large and small—from ending ineffective programs to subtly modifying the design or administration of incentives—can greatly improve the effectiveness of state economic development efforts.

Building on earlier research by The Pew Charitable Trusts, this report identifies best practices for effectively evaluating tax incentives. Specifically, Pew recommends that states take three steps:

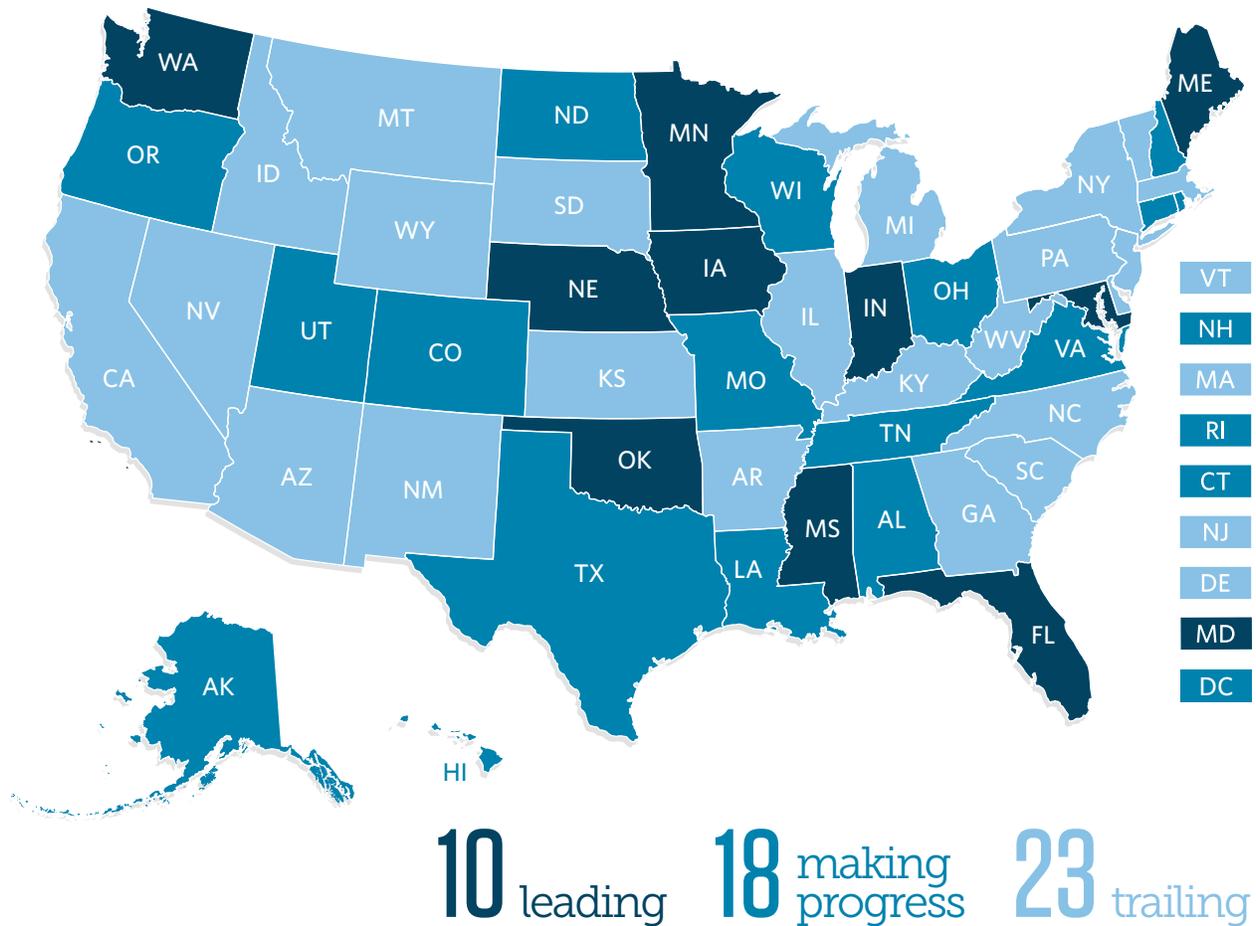
**1. Make a plan.** Lawmakers need to put processes in place to regularly evaluate the results of major tax incentives. Well-designed evaluation plans ensure that the state’s full portfolio of incentives is examined, that nonpartisan staff with relevant expertise are tasked with the analyses, and that the reviews take place on a strategic schedule.

**2. Measure the impact.** High-quality evaluations carefully assess the results of incentives for the state’s budget and economy. To do so, evaluators must estimate the extent to which incentives successfully changed business behavior, as opposed to rewarding what companies would have done anyway.

**3. Inform policy choices.** Lawmakers and executive branch officials should use the findings of evaluations to improve the effectiveness of tax incentives. Policy improvements are more likely when states have a formal process that ensures lawmakers will consider the results—for example, by holding legislative hearings on evaluations.

Pew staff assessed each state on the extent to which it has taken each of these steps. To do so, Pew staff gathered and analyzed tax incentive evaluations and other state documents. We also interviewed state officials and other experts from all 50 states and the District of Columbia. Based on this research, states were rated as “leading,” “making progress,” or “trailing.” The leading states have achieved success on all three criteria, while those that are making progress have put in place a plan for regular evaluation.

Figure 1  
 State Tax Incentive Evaluation Ratings



Note: The leading states have well-designed plans to regularly evaluate tax incentives, experience in producing quality evaluations that rigorously measure economic impact, and a process for informing policy choices. The states that are making progress have made a plan by enacting a policy that requires regular evaluation of major tax incentives. The trailing states lack a well-designed plan to regularly evaluate major tax incentives.

Source: Pew analysis based on interviews with state officials and a review of tax incentive evaluations and evaluation statutes

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Taken as a whole, more states are evaluating incentives, with far more rigor and policy impact, than were doing so just a few years ago. In 2015 and 2016, 13 states approved laws requiring regular evaluations. But all states still have room to improve. This report describes the strengths and weaknesses of each state’s approach to evaluating incentives, and offers options for how states can enhance their efforts. The 23 states that are still trailing can start by making a well-designed evaluation plan. States that have taken that first step can offer lawmakers high-quality analysis that helps inform their policy choices.

Evaluating incentives well takes time, effort, and persistence. The payoff, though, is worth it: Policymakers have the information they need to ensure that economic development tax incentives achieve strong results for states’ budgets, businesses, and workers.

## Evidence leads to better policy

For more than 30 years, Florida offered an array of incentives to businesses that locate, invest, and hire in the state's distressed areas through an initiative known as the Enterprise Zone Program. When nonpartisan legislative staff studied the program in 2014, however, they found that it was providing a much weaker return on the state's investment than other incentives.<sup>1</sup>

The analysis determined that the program was largely rewarding businesses for activity that would have taken place in Florida anyway rather than encouraging new investments.<sup>2</sup> Nor was it doing much to boost distressed areas: The enterprise zones generally were faring worse than similar areas that were not part of the program.<sup>3</sup>

Because the state was poised to spend tens of millions of dollars on the program in coming years, legislators were concerned by these findings. They asked legislative staff for additional analysis on the program's results and potential policy alternatives, information staff members provided in 2015.<sup>4</sup> Ultimately, lawmakers decided to allow the program to expire at the end of 2015.<sup>5</sup>

Like Florida, Maryland has used evaluations to improve economic development policy. In 2016, for example, lawmakers faced a decision on whether a tax credit for rehabilitating historic buildings should be extended beyond its scheduled 2017 expiration date. A legislative staff evaluation recommended potential improvements to the tax credit, including modifying the scoring system used to determine which projects qualify. The evaluation found that the system did not always target funding to the projects that would provide the greatest economic benefits, thus limiting the effectiveness of the credit. The legislative staff also praised key protections that successfully ensured that the credit did not cost more than intended.<sup>6</sup> In response, lawmakers altered the scoring system and extended the program for five years.<sup>7</sup>

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By tasking professional staff—such as auditors, economists, and tax policy experts—with studying tax incentive programs in detail, states can determine how well their incentives are performing.

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These experiences in Florida and Maryland show the value of evaluating tax incentives regularly and rigorously. By tasking professional staff—such as auditors, economists, and tax policy experts—with studying tax incentive programs in detail, states can determine how well their incentives are performing. This information can help states modify or end ineffective programs or help them invest with confidence in incentives that are working well.

Until recently, tax incentives rarely received this type of scrutiny, in part because these incentives do not generally have to be reapproved with each state budget; instead, many were created as permanent parts of state code. So while lawmakers regularly debate state spending for education, health care, transportation, corrections, and other government functions as part of the budget process, tax incentives often have not been part of the conversation. "It just seems like we're only looking at one side of the equation if we're not looking at the investments we make in tax expenditures," said former state Representative Adam Goode (D), who was a key supporter of Maine's 2015 evaluation law as chairman of the Legislature's Joint Standing Committee on Taxation.<sup>8</sup> Lawmakers and staff may not have the time or resources to review every incentive with each new budget, but by evaluating incentives on regular cycles they can ensure that the programs are no longer ignored.

Maine is one of many states that have begun to gather better information on the results of incentives in recent years. Since the start of 2012, 21 states and the District of Columbia have approved laws requiring regular

evaluation.<sup>9</sup> In 2015 and 2016, 13 states approved such laws. Meanwhile, other states with longer-standing evaluation processes, such as Oregon and Washington, have continued to work to improve their efforts.<sup>10</sup>

Table 1

## The Spread of Tax Incentive Evaluation Laws

Year laws were enacted in states that are “leading” or “making progress”

State	Year enacted
Alabama	2016
Alaska	2014
Colorado	2016
Connecticut	2010
District of Columbia	2014
Florida	2013
Hawaii	2016
Indiana	2014
Iowa	2010
Louisiana	2013
Maine	2015
Maryland	2012
Minnesota	2015
Mississippi	2014
Missouri*	1999
Nebraska	2015
New Hampshire	2014
North Dakota	2015
Ohio	2016
Oklahoma	2015
Oregon**	2009
Rhode Island	2013

State	Year enacted
Tennessee	2015
Texas	2015
Utah	2016
Virginia	2016
Washington	2006
Wisconsin	2011

\* 1999 legislation required the state auditor to evaluate tax incentives, while 2003 legislation established required studies from the Legislature's Oversight Division.

\*\* 2013 legislation tasked the Legislative Revenue Office with evaluating incentives, significantly formalizing the process.

Source: Tax incentive evaluation laws

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Lawmakers around the country say they have begun seeking better information on tax incentives because these programs are among the primary tools states use to try to create jobs, raise wages, and attract businesses—key priorities for elected officials across the political spectrum. Incentives are also major budget commitments, collectively costing states billions of dollars each year.<sup>11</sup> “We pass these tax credits and people tell us they’re going to be great for the state, they’re going to create jobs, there’s going to be a big payback,” said Del Marsh (R), president pro tem of the Alabama Senate.<sup>12</sup> “It’s time to look at some of these closer to see if they have a net gain for the state.” In 2016, Alabama adopted evaluation legislation to do just that.<sup>13</sup>

Sen. Marsh’s view is shared by legislators in other states, several of which have adopted evaluation laws because of doubts about whether the programs were achieving their goals. When designed and managed well, tax incentives can strengthen a state’s economy. But they sometimes have proved to be costly commitments with few corresponding economic benefits.

In Hawaii, for example, lawmakers closed an incentive program for high-tech companies in 2010 amid doubts about the program’s effectiveness. Five years later, Hawaii’s state auditor reported that the state still faced obligations of hundreds of millions of dollars under the program—a consequence of rules that allow companies to carry forward tax credits they earned under the high-tech incentive indefinitely.<sup>14</sup> In 2016, Hawaii lawmakers approved legislation requiring the auditor to evaluate tax incentives regularly.<sup>15</sup>

Evaluations can also help lead to a more constructive conversation about incentives. In Oklahoma, supporters of incentives argued for years that the programs were essential to stay competitive with other states, while skeptics viewed them as unnecessary meddling in the economy. These differences of opinion often led to difficult debates in the Legislature.<sup>16</sup> Ultimately, though, supporters and skeptics agreed that better information would help guide their decisions. “I’ve always said that the state should keep incentives that work and phase out those that don’t,” Governor Mary Fallin (R) said in her 2015 State of the State address proposing evaluation legislation that was enacted later that year. “The problem is we do not have an effective and objective way of evaluating these incentives.”<sup>17</sup> Even if evaluations do not end all the disagreements, officials hope that the objective information gathered will serve as a common starting point for discussions.

As incentives must work well for businesses, evaluations should also help ensure that they do. Colorado's 2016 evaluation law, for example, includes requirements that evaluators consider business needs and seek business input.<sup>18</sup> In Colorado, one of the strongest supporters of evaluation is the state chapter of the National Federation of Independent Business. "It is imperative the more than \$4 billion of state revenues being used for these tax exemptions and credits be measured for their effectiveness," the state chapter posted on its website after the evaluation legislation passed. "If businesses receiving preferential treatment are indeed creating the jobs that warrant it, then let's continue them. But we don't know that until we find out."<sup>19</sup>

## How states are doing

This report describes three steps for states to use evidence to improve tax incentives: making a plan, measuring the impact, and informing policy choices. These criteria were selected because they lead to regular, high-quality analyses that lawmakers use to improve the results of the state's economic development efforts.

Pew assessed every state on the extent to which they have successfully taken these steps since the start of 2012, based on interviews with state officials and other experts, including at least one official from every state. These interviews were conducted with those who evaluate and those who administer incentives, state lawmakers, and other experts. Pew also gathered and analyzed tax incentive evaluations, evaluation laws, and other state documents. Evaluations use information on both the costs and benefits of incentives to gauge programmatic effectiveness. Other types of documents that states produce on incentives, such as studies that report on the performance of specific companies receiving incentives or on the costs of incentives without analyzing benefits, were not included in Pew's assessment. Our standards for determining whether states had met the three criteria were as follows:

**1. Make a plan.** To meet this standard, states needed to establish policies requiring evaluation of major tax incentives. If a policy had been in place for five years or more, the state needed to have implemented it by actually producing evaluations.

**2. Measure the impact.** To meet this standard, state evaluations needed to estimate the extent to which incentives successfully changed business behavior, as opposed to rewarding what companies would have done anyway—a key question for assessing the results of incentives for the state's budget and economy. In practice, states that met this standard also addressed other key questions regarding economic impact, such as whether incentives benefit some businesses at the expense of others.

**3. Inform policy choices.** To meet this standard, states needed to have made changes to incentives that were consistent with the findings of evaluations or have a formal process that ensures lawmakers will consider the results—for example, by holding legislative hearings on evaluations.

Based on this research, states were rated as leading, making progress, or trailing.

- The 10 leading states—Florida, Indiana, Iowa, Maine, Maryland, Minnesota, Mississippi, Nebraska, Oklahoma, and Washington—have taken meaningful steps to achieve all three criteria. They have well-designed plans to regularly evaluate tax incentives, experience in producing quality evaluations that rigorously measure economic impact, and a process for informing policy choices.
- An additional 17 states plus the District of Columbia are making progress toward becoming leaders. Each state has made a plan by enacting a policy that requires regular evaluation of major tax incentives. However, they have not met all three criteria. Thirteen of these states and the District have passed evaluation laws since

the start of 2012 and are working on implementation. Of the remaining four, Connecticut produces high-quality evaluations but does not have a structure for informing policy choices. And while Missouri, Oregon, and Wisconsin have provided valuable analysis of program design and administration, they do not rigorously measure the economic impact of incentives.

- The final 23 states are trailing. They either lack an evaluation policy or have had a policy in place for five years or longer that has not been effective in measuring impact or helping lawmakers improve programmatic effectiveness.

For each state's rating, see Figure 1. Details on the strengths and weaknesses of each state's approach are available in the state fact sheets at the end of this report.

### States That Are Trailing

Despite progress across the country, many states still lack regular evaluation processes. In several, incentives are a major investment. For example, incentives cost Pennsylvania more than \$700 million a year.<sup>20</sup> New Jersey's Economic Development Authority has incurred obligations of more than \$3 billion in incentives for fiscal years 2016 through 2020.<sup>21</sup> In 2014, Nevada agreed to provide \$1.3 billion in incentives to Tesla to encourage the car manufacturer to build a battery factory in the state.<sup>22</sup>

Many of the states without processes for ongoing evaluation have conducted ad hoc studies. In doing so, these states have proved they are capable of producing high-quality analyses of tax incentives. A series of evaluations in California, for example, found that the Enterprise Zone Program was an ineffective tool for boosting state employment. In response, lawmakers replaced it in 2013 with three new incentives designed to address the program's flaws.<sup>23</sup> Without regular evaluations, however, lawmakers may lack the information they need to determine whether these new incentives have succeeded. Other incentives—including one of California's costliest, the \$1.5 billion-a-year Research Credit—have not been rigorously evaluated.<sup>24</sup>

Three other states in this group, Arizona, Delaware, and New Mexico, have been studying incentives for years but without rigorous analysis. For example, as a result of a 2011 executive order, New Mexico publishes an inventory of the state's tax credits, exemptions, and deductions each year.<sup>25</sup> While the reports have identified needed technical corrections to incentives, they lack detail on the economic impacts of the programs.<sup>26</sup>

Lawmakers in several states without ongoing evaluation processes—including California, Michigan, Nevada, and Vermont—have discussed proposals for implementing such processes. California's state auditor wrote in a 2016 report, "By requiring periodic reviews of tax expenditures and then connecting the reviewing entities' conclusions and recommendations to the policymaking process, the Legislature would create a valuable tool that could improve tax expenditures and reduce the risks of tax expenditures not achieving their intended purposes and forgoing needed revenue."<sup>27</sup>

## Steps to more effective tax incentives

Evaluations have helped policymakers improve the results of tax incentives by investing in programs that are working well, ending ones that are working poorly, or making modifications that lead to better outcomes. States are more likely to achieve these goals when they have a well-designed plan for evaluation, high-quality studies that measure impact effectively, and a process for using the findings to inform policy.

### 1. Make a plan

When policymakers consider creating evaluation processes, they face a variety of choices. Which incentives should be evaluated? What should the review schedule look like? Who should be tasked with conducting the analysis? How should lawmakers consider the findings? Each of the 28 jurisdictions that are leading or making progress—27 states and the District of Columbia—have answered these questions and others differently. In many cases, they have successfully customized the processes to their own needs and circumstances. In other instances, changes might help ensure that the evaluations provide higher-quality information.

#### Include the state's full portfolio

One of the most basic decisions for policymakers when designing an evaluation process is which programs to review. The answer is: all major economic development tax incentives, in order to give lawmakers information on each and help facilitate comparisons between the results of different programs.

Table 2

### The Scope of Tax Incentive Evaluation Laws

Types of programs that are evaluated in addition to economic development tax incentives in states that are “leading” or “making progress”

State	Includes cash incentives (such as grant and loan programs)?	Includes other tax expenditures (such as those that benefit individuals)?
Alabama	No	No
Alaska	No	Yes
Colorado	No	Yes
Connecticut	No	No
District of Columbia	No	Yes
Florida	Yes	No
Hawaii	No	Yes
Indiana	No	Yes

*Continued on next page*

State	Includes cash incentives (such as grant and loan programs)?	Includes other tax expenditures (such as those that benefit individuals)?
Iowa	No	Yes
Louisiana	No	Yes
Maine	No	Yes
Maryland	No	Yes
Minnesota	Yes	No
Mississippi	Yes	No
Missouri	Yes	Yes
Nebraska	No	No
New Hampshire	No	Yes
North Dakota	No	No
Ohio	No	Yes
Oklahoma	Yes	No
Oregon	No	Yes
Rhode Island	No	No
Tennessee	No	No
Texas	Yes	No
Utah	No	Yes
Virginia	Yes	No
Washington	No	Yes
Wisconsin	Yes	No

Source: Tax incentive evaluation laws and other state documents

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Some states are falling short of that standard. For example, Wisconsin’s Legislative Audit Bureau studies programs administered by the Wisconsin Economic Development Corp. but not others, such as the \$36 million Research Expenditures Credit operated by other agencies.<sup>28</sup> In contrast, Indiana has designed a more comprehensive evaluation process. Indiana’s evaluation law mandates that the state’s Legislative Services Agency evaluate all tax incentives, regardless of which tax (such as income, sales, and property) the incentive can be claimed against and what form the incentive takes (a credit, exemptions, or deduction).<sup>29</sup>

States should also ensure that the process remains comprehensive. Most states require evaluation of new incentives created by lawmakers, but the laws in Hawaii, Florida, Maryland, North Dakota, and Tennessee do not; as a result, the burden is on their lawmakers to periodically add new incentives to the evaluation schedule.<sup>30</sup>

Some states, including Florida, Oklahoma, and Virginia, evaluate cash incentives such as grants and loans in addition to tax incentives.<sup>31</sup> If a state’s portfolio includes major cash incentives—Oklahoma’s Quality Jobs Program, for instance, is a cash rebate that is one of the state’s largest incentives—then studying both tax and cash programs may help lawmakers determine which ones are most effective.<sup>32</sup>

Other states have found many ways to tailor their processes to their specific needs. For example, lawmakers in Minnesota have in recent years committed hundreds of millions of dollars to incentives for specific major employers, such as the Mayo Clinic, the Mall of America, and the Minnesota Vikings.<sup>33</sup> With that in mind, the state’s 2015 evaluation requires the legislative auditor to report on best practices for these company-specific incentives in addition to requiring evaluation of tax incentive programs.<sup>34</sup> The best practices reports can help guide the Legislature’s decision-making on similar deals in the future.

### Set a strategic schedule

Many states have adopted rotating cycles for evaluation, with a different group of programs examined each year. As a result, both evaluators and lawmakers are able to focus in more depth on a subset of programs.

Other states might benefit from this approach. For example, Louisiana agencies evaluate every tax credit each year.<sup>35</sup> The evaluations tend to be formulaic and provide limited analysis of the economic impact of incentives. By focusing on a subset of programs in each evaluation, the state might be able to provide more sophisticated, customized analyses.

Table 3

## Laws Establish Regular Evaluation

Length of tax incentive review cycles in states that are “leading” or “making progress”

State	Cycle length (years)
Alabama	4
Alaska	6
Colorado	5
Connecticut	3
District of Columbia	5
Florida	3
Hawaii	5 or 10*

*Continued on next page*

State	Cycle length (years)
Indiana	5
Iowa	5
Louisiana	1
Maine	6
Maryland	7
Minnesota	At least one evaluation a year <sup>†</sup>
Mississippi	4
Missouri	4 <sup>‡</sup>
Nebraska	3
New Hampshire	5
North Dakota	6
Ohio	8
Oklahoma	4
Oregon	6
Rhode Island	3
Tennessee	4
Texas	No schedule adopted yet <sup>§</sup>
Utah	3
Virginia	6 or 8 <sup>  </sup>
Washington	10
Wisconsin	2

\* Depends on the tax type, e.g. income tax expenditures will be evaluated every five years while general excise tax expenditures will be evaluated every 10 years.

† No set cycle, but the legislator auditor is required to consider “the legislature’s need for regular information on the results of all major general incentives” when recommending a schedule.

‡ Has not consistently followed schedule.

§ Schedule will be determined by the Economic Incentive Oversight Board.

|| Preliminary decision, with refinements to the schedule expected in 2017.

Source: Tax incentive evaluation laws and other state documents

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In determining the length of the review cycle, states should consider both lawmakers' need for reasonably up to date information and the finite capacity of the evaluators. To strike this balance, many states evaluate each tax incentive every three to five years. Others, such as Alaska, Maine, Oregon, and Washington, evaluate incentives on six- to 10-year cycles.<sup>36</sup> Most of these states study other types of tax expenditures that primarily benefit individuals in addition to those that are claimed by businesses. The longer cycles are necessary because the evaluation offices in these states are studying dozens or even hundreds of programs.

Even with the longer cycles, these evaluation offices may face a sizable task, which state officials can help mitigate by prioritizing the most important tax expenditures. In Washington, the staff of the Joint Legislative Audit and Review Committee (JLARC) has evaluated hundreds of tax expenditures over the last decade.<sup>37</sup> In 2016, the citizen commission that oversees JLARC's reviews decided to exempt from evaluation over the next 10 years dozens of tax expenditures that officials had deemed consistent with basic principles of tax policy (such as avoiding double taxation).<sup>38</sup> While JLARC already produces high-quality studies, this decision will help the evaluators focus even more closely on economic development tax incentives and other high-priority tax expenditures.

In designing a schedule, one approach that has worked well for states such as Florida, Oregon, and Washington is to study incentives with similar purposes in the same year, allowing lawmakers to compare the results of incentives with the same goals and ensure that they are coordinated effectively. For example, Oregon evaluates tax credits on a six-year cycle. In 2015, the state evaluated several credits designed to promote public health and human services.<sup>39</sup> When lawmakers learned that two credits for child care expenses had separate eligibility standards, they consolidated the credits into one means-tested program, with greater benefits for lower-income taxpayers.<sup>40</sup>

### Select evaluators with the right skill set

When the right state office leads tax incentive evaluations, the documents are more likely to provide high-quality analysis to policymakers. Ideally, the office selected to evaluate tax incentives would have:

- **An ability to draw policy-relevant conclusions.** The primary reason to evaluate incentives is to help lawmakers identify how to make state economic development policy as effective as possible. To serve this purpose, evaluators should be willing to describe what is working, what is not, and how incentives can be improved.
- **Experience at program evaluation.** Evaluating incentive programs requires many of the same skills needed to examine other government programs. To help determine whether the programs can work more efficiently and effectively, evaluators frequently synthesize interviews with stakeholders, research national best practices, and study the details of how incentives are administered.
- **Experience measuring fiscal and economic impact.** To determine an incentive program's results, evaluations need to generate an accurate picture of its benefits and costs. Evaluation offices should have the expertise to answer key questions, such as to what extent incentives influenced businesses' choices, how those decisions affected the state's economy, and what it cost the state to achieve the results.
- **An impartial, nonpartisan perspective.** Evaluators should base their findings on the evidence at hand, free to the extent possible from bias.

A common approach is to require nonpartisan legislative staff to evaluate incentives. Policymakers have tasked legislative audit or program evaluation offices with studying incentives in Colorado, Florida, Hawaii, Maine, Minnesota, Nebraska, Virginia, Washington state, and Wisconsin.<sup>41</sup> These offices are a good fit because they

regularly study government agencies and programs and recommend improvements. While many legislative audit offices lack experience measuring economic impact, they can build that capacity over time. Washington’s legislative audit staff, for example, performs sophisticated economic analysis in its evaluations.

Table 4

## Who Evaluates Tax Incentives

Evaluation offices in states that are “leading” and “making progress”

State	Evaluation office
Alabama	State agencies that administer incentives
Alaska	Legislative Finance Division
Colorado	Office of the State Auditor
Connecticut	Department of Economic and Community Development
District of Columbia	Office of the Chief Financial Officer
Florida	Office of Economic and Demographic Research/Office of Program Policy Analysis and Government Accountability
Hawaii	Office of the Auditor
Indiana	Legislative Services Agency
Iowa	Department of Revenue
Louisiana	State agencies that administer incentives
Maine	Office of Program Evaluation and Government Accountability
Maryland	Department of Legislative Services
Minnesota	Office of the Legislative Auditor
Mississippi	University Research Center
Missouri	Office of the State Auditor/Legislature’s Oversight Division
Nebraska	Legislative Audit Office
New Hampshire	Joint Committee on Tax Expenditure Review
North Dakota	Political Subdivision Taxation Committee*
Ohio	Tax Expenditure Review Committee
Oklahoma	Private consultants†

Continued on next page

State	Evaluation office
Oregon	Legislative Revenue Office
Rhode Island	Office of Revenue Analysis
Tennessee	Private consultants <sup>‡</sup>
Texas	Economic Incentive Oversight Board
Utah	Office of the Legislative Fiscal Analyst/Governor's Office of Economic Development
Virginia	Joint Legislative Audit and Review Commission
Washington	Joint Legislative Audit and Review Committee
Wisconsin	Legislative Audit Bureau

\* Evaluation law requires an interim committee to review incentives. Political Subdivision Taxation Committee selected in the first interim under the law.

† Evaluation law permits state to contract with a private contractor or academic institution to evaluate incentives. Private consultants hired for first year of evaluations.

‡ Evaluation laws tasks the “commissioner of economic and community development, in consultation with the commissioner of revenue” to review incentives. These officials hired private consultants for the first evaluation under the law.

Source: Tax incentive evaluation laws and other state documents

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Other types of legislative staff offices have also had success. Analysts for Indiana’s Legislative Services Agency (LSA) have produced some of the most rigorous economic analyses in the country. While the LSA, like many legislative research agencies, does not typically make policy recommendations, the evaluations have still proved valuable to policymakers by offering clear guidance on whether incentives are effective. For example, the LSA concluded in 2014 that two tax incentives for home energy efficiency products were likely doing little to encourage purchases of those items.<sup>42</sup> In response, lawmakers ended both programs in 2015.<sup>43</sup>

Partnering with academic institutions or private consultants can also be a strong option, especially if no state office has the ideal mix of expertise and independence. For example, under a 2014 law, Mississippi assigned evaluation responsibility to a research center that is part of the state’s public university system, which already assisted on the state’s revenue forecasts.<sup>44</sup> On the other hand, Oklahoma has hired a private consulting firm with experienced former state officials on its staff to evaluate incentives.<sup>45</sup>

States have had success contracting with outside experts to study incentives when the evaluators receive clear direction on what information will be most useful to policymakers. Arkansas previously contracted with academic economists to measure the impact of incentives but ended the arrangement after the analysis proved too technical and abstract to be useful.<sup>46</sup> Oklahoma’s approach has succeeded in producing clear policy recommendations in part because a state commission identifies the goals of incentives and what the private consultants should measure to determine whether those goals have been achieved.

Other states have not ensured that evaluations will provide high-quality information. For example, a 2014 New Hampshire law created a legislative committee to review tax expenditures, while Texas’ 2015 evaluation

law created a citizen board to study incentives.<sup>47</sup> Convening a panel to discuss incentives can lead to useful conclusions. However, the states that have had success with this approach, such as Oklahoma, Oregon, and Washington, task professional staff with producing written evaluations to inform the work of the panel.<sup>48</sup> In Texas, the governor’s economic development office staffs the board, but is not required to provide formal evaluations.<sup>49</sup> Other offices that could offer a more independent perspective lack an official role.

### Gather relevant data

Any tax incentive evaluation is only as good as the available data. States possess much of the needed data, but it is often spread across multiple agencies and may not be organized in such a way as to easily facilitate evaluation. Additionally, when the information is sensitive—such as business plans or tax records of specific companies—state agencies are sometimes reluctant to share it even with one another.<sup>50</sup>

Given these challenges, one of their first steps after states establish regular evaluations should be to plan how to collect relevant data. For example, Nebraska approved evaluation legislation in 2015, then enacted additional legislation in 2016 to make it easier for evaluators to receive complete, timely data from the tax department while protecting sensitive information.<sup>51</sup> The first evaluation under the law, published in November 2016, offered additional recommendations for increasing the data available.<sup>52</sup>

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## Any tax incentive evaluation is only as good as the available data.

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Relevant information can also come from other sources, including businesses, federal records, and third-party databases.<sup>53</sup> The economists in Iowa’s Department of Revenue who evaluate incentives convene an advisory panel for each evaluation that includes officials from the agency that administers the incentives, as well as relevant academics and industry representatives. These panels have helped the economists determine what data are available to measure a program’s results while also guiding the evaluators on how incentives function and each program’s goals.<sup>54</sup>

## 2. Measure the impact

Evaluations examine the results of incentives for the state’s budget and economy. To put these findings in context, the studies often consider whether the programs are well-designed in order to achieve their goal and whether they are being administered efficiently. In doing so, evaluations can provide policymakers with guidance on whether incentives are working well, why or why not, and how to make improvements.

### Analyze to what extent the incentive is influencing business behavior

The point of incentives is to encourage companies to create jobs and make investments that they otherwise would not. However, incentive programs often at least partially reward businesses for what they would have done anyway. While evaluators sometimes assume that all new activity by businesses receiving incentives resulted from the programs—leading to flawed results—evaluations in many states have arrived at reasonable estimates of the extent to which the programs changed business behavior.

One effective approach is to place the size of the incentive in the context of taxpayers’ overall costs. All else being equal, an incentive that reduces a business or individual’s costs by 10 percent is more likely to influence

decisions than one that reduces costs by 1 percent. Based on this principle, academic researchers have developed estimates of the extent to which taxpayers and businesses in various industries change their behavior in response to reductions in their costs. Evaluations can use these estimates to measure the effectiveness of incentives.

For example, a 2014 Indiana evaluation of a tax deduction for solar-powered roof vents or fans—products that homeowners install in their attics to try to boost energy efficiency—found that the provisions saved taxpayers only 2.3 percent on the cost of installation. This reduction was too small to appreciably affect the installations, based on academic literature on the responsiveness of taxpayers to changes in the costs of energy efficiency products.<sup>55</sup>

In other cases, states have used common sense to determine whether incentives are influencing business behavior. In 2016, Oklahoma evaluated a tax incentive for local organizations that host events such as sports competitions. The evaluation found that the local organizations were not considering the incentive when developing bids to attract events because they were unsure of the dollar value of the incentives they would receive and when they would be allowed to claim them. Since the incentive was not being used to develop the bids, it clearly was not influencing whether the events located in Oklahoma communities. To improve the program's effectiveness, the evaluation recommended administrative changes designed to provide the local organizations with more certainty about the value and timing of incentives.<sup>56</sup>

### Measure the economic trade-offs of paying for incentives

States could use the money dedicated to incentives for alternatives that would also stimulate some economic activity, such as increases in government spending or cuts in tax rates. With that in mind, high-quality evaluations do not simply judge an incentive program to be a success if it created some jobs or attracted some businesses. Instead, they compare the results of the incentives to the results of potential alternatives.

For example, in a 2015 evaluation, Maryland's Department of Legislative Services (DLS) calculated the economic benefits of the state's film tax credit. DLS also estimated the economic costs of not having the dollars the state used on the film credit available for general government purposes. (Paying for the credit meant the state employed fewer workers than it might otherwise have and state workers spent less money in the economy.) The evaluation showed that, when taking both the positive and negative effects into account, the program initially provided some benefits but ultimately reduced employment and personal income in Maryland. That finding was one reason DLS recommended ending the program.<sup>57</sup>

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## High-quality evaluations compare the results of the incentives to the results of potential alternatives.

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A 2015 evaluation of Washington's film tax credit used an innovative approach to consider its effectiveness in influencing business decisions and the trade-offs associated with paying for it. The evaluation calculated the break-even point for the film credit: What percentage of film spending in Washington would need to have been caused by the credit for it to be better than using the dollars for general government spending? The report estimated that 45 percent of film spending would need to be caused by the credit for it to increase state employment by a greater amount than the government spending alternative, for example. By estimating the break-even point, Washington's evaluation provided a starting point for policymakers to determine whether the incentive is likely to induce enough economic activity to be worth the cost.<sup>58</sup>



### Estimate indirect effects

Providing incentives to some businesses can help others to grow, as dollars from the company receiving incentives circulate in the broader economy. But incentives can also have harmful indirect effects, if some businesses receive a competitive advantage at the expense of others. Economists at Mississippi’s University Research Center, for example, questioned the effectiveness of an incentive for “cultural retail attractions” such as outlet malls. The incentive hurt other Mississippi retailers, the evaluation argued, since many of the shoppers at the attractions were likely to be Mississippi residents who would have spent much of their disposable income elsewhere in the state. The report concluded that focusing on projects that would draw a greater share of customers from out of state would have a bigger impact.<sup>59</sup>

States have often used economic modeling software—REMI and IMPLAN are two of the most common models—to estimate the indirect effects of incentives. The strength of these models is that they can be used to measure how one change in the economy, such as the decision to offer incentives, affects other businesses and residents. However, these models are only as good as the data and assumptions that analysts use—including estimates of the extent to which incentives changed taxpayer behavior.

Lower-quality evaluations often simply report the indirect effects of incentives as estimated by economic modeling, without explaining the basis for the findings and their limitations. In contrast, states such as Florida and Washington are transparent about the assumptions that go into the models. For example, the staff of Washington’s Joint Legislative Audit and Review Committee (JLARC) used REMI to measure the results of incentives for the aerospace industry in a 2014 evaluation. In the study, JLARC also explained its rationale for using REMI and compared the aerospace industry’s “multipliers”—estimates of the extent to which industry spending will ripple into the broader economy—in REMI and in an alternative economic model.<sup>60</sup> Such discussions can help demystify economic modeling for policymakers, leading them to trust the results and act on them.

## Study whether incentives are well-designed to achieve their goals

Incentive programs differ in many ways. Two of the most important differences include:

- **Who benefits:** Incentives may be offered for a specific activity, such as job creation, or a specific industry. Many programs also have a geographic component, with benefits directed to distressed areas, for example. For some programs, a state agency or panel has discretion to determine which companies receive incentives, while for others every company that meets predetermined eligibility criteria is allowed to participate.
- **The mechanism for calculating and claiming the benefits:** States offer both tax incentives and cash incentives. Even within those categories, there is great variation. Tax incentives might take the form of credits, deductions, or exemptions. The timing of claiming these benefits also varies by program. In some cases, businesses receive incentives upfront; in others, companies must meet performance standards before they can claim incentives.

Given all the variation, high-quality evaluations carefully consider whether incentives are well-designed to achieve their policy goals. For example, when North Dakota reviewed its Angel Fund Investment Tax Credit in 2016, policymakers learned that program rules allow these funds to invest in out-of-state companies, many of which have no economic activity in North Dakota.<sup>61</sup> This finding prompted lawmakers to begin discussing either ending the program or modifying it to ensure that North Dakota companies benefit.<sup>62</sup>

Studying the design of incentives can provide valuable context for the results of economic analysis. In discussing options for improving Florida's Enterprise Zone Program, legislative staffers highlighted several features that tend to improve the performance of incentive programs—including strong wage standards and job training requirements. The study noted that the Enterprise Zone Program lacked several of these features, leading to a weak return on the state's investment.<sup>63</sup>

## Review program administration

Tax incentives, like other government programs, can be administered efficiently or inefficiently. For example, a series of reports from Wisconsin's Legislative Audit Bureau (LAB) found weaknesses in the Wisconsin Economic Development Corp.'s (WEDC) approach to determining whether businesses qualify for incentives and monitoring company performance.<sup>64</sup> A 2015 audit, for instance, found that WEDC was administering incentives based on program policies that were in place when the corporation initially struck deals with businesses, rather than the policies in place when the incentives contracts were executed. Since many months sometimes pass between the initial deal and contract execution, LAB argued that WEDC was operating the programs in ways that were inconsistent with current state law or policy.<sup>65</sup> In response, WEDC has pledged to make many of LAB's recommended changes, including shifting to administering incentives based on the policies in place at their execution date.<sup>66</sup>

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Studying the design of incentives can provide valuable context for the results of economic analysis.

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Missouri, where the office of the state auditor regularly evaluates incentives, has excelled at evaluations that point out ways to improve program operations. A 2014 audit, for example, recommended that lawmakers consider establishing stricter eligibility criteria for the Historic Preservation Tax Credit Program because the program had provided incentives to build expensive owner-occupied residential projects with minimal economic benefit to the state.<sup>67</sup>

Likewise, a 2014 audit of Missouri’s Brownfield Remediation Tax Credit Program, an incentive that encourages redevelopment of environmentally contaminated sites, noted that the Missouri Department of Development (DED) sometimes provided credits to pay for 100 percent of the costs of environmental remediation as part of redeveloping the sites. The audit argued that paying 100 percent of qualifying costs provided little motivation for developers to keep their expenses in check.<sup>68</sup> In response, DED began offering credits worth 100 percent of costs only when developers had used competitive bidding to contract for remediation work, thereby making excessive costs less likely.<sup>69</sup>

## Assess fiscal protections

Evaluations can analyze whether adequate protections are in place to ensure that the costs of incentives do not increase quickly and unexpectedly, thereby causing budget challenges. In Maryland’s 2015 evaluation of a tax credit for rehabilitating historic buildings, the authors pointed out that the cost is limited by the amount of money lawmakers specifically appropriate to the program. Using the appropriations process, the report concluded, ensured that the incentive would not cost more than intended.<sup>70</sup> With that assurance, lawmakers decided in “2016 to continue the program for five years beyond its scheduled 2017 expiration date.”<sup>71</sup>

### Reducing Budget Risks

In recent years, many states such as Hawaii, Michigan, Louisiana, and Oklahoma have experienced serious budget challenges after the costs of incentives increased beyond policymakers’ expectations.<sup>72</sup> Earlier Pew research describes two strategies state officials can use to help avoid these situations.

**1. Gather and share high-quality data on the costs of incentives.** By regularly forecasting the costs and monitoring the states’ commitments—especially under large or high-risk programs—states can make sure they are not caught off guard by unexpected cost increases.

**2. Design incentives in ways that reduce risk.** For example, one of the strongest protections against incentives costing more than intended is an annual limit on program costs. States have also tied incentives to company performance to avoid the worst-case scenario: incentives that prove costly without corresponding economic benefits.<sup>73</sup>

Evaluations can also warn when costs may be increasing unsustainably. In Nebraska, a 2016 evaluation noted that the costs of the state’s largest incentive, the Nebraska Advantage Act, are beginning to exceed lawmakers’ initial expectations. The study found that the program lacks sufficiently strong protections to prevent future cost increases.<sup>74</sup> In response, the Nebraska Legislature’s Performance Audit Committee, which oversees the evaluation process, recommended that colleagues in the Legislature consider whether changes to the program are needed to ensure that it does not cause budget difficulties.<sup>75</sup>



### 3. Inform policy choices

When states evaluate incentives, it's important to provide opportunities for policymakers to translate the results into action to improve policy.

#### Mandate legislative hearings

Most states that regularly evaluate incentives have designated a specific legislative committee to hold hearings to discuss the results of evaluations, receive input from stakeholders (including the businesses receiving the incentives and the agencies administering them), and consider whether policy changes are needed. Some states have simply mandated that relevant existing committees hold periodic hearings on evaluations, while others have created new panels specifically for this purpose.

In North Dakota, the Political Subdivision Taxation Committee held a dozen hearings on incentives in 2015 and 2016 under the state's 2015 evaluation law. At the hearings, the committee received analysis of the programs from legislative staff and heard from other stakeholders, including the office of the state tax commissioner, the Department of Commerce, local economic development organizations, and business associations.<sup>76</sup> Based on this information, the committee provided detailed recommendations to the full Legislature, proposing that lawmakers end some incentives and continue others with or without changes.<sup>77</sup>

In some states, however, evaluations are simply delivered to legislative or executive branch officials, with no required follow-up. As a result, improvements to incentives are less likely. In Connecticut, for example, the Department of Economic and Community Development produced an evaluation that rigorously measured the economic impact of the state's tax incentives in 2014.<sup>78</sup> Without legislative hearings, however, the report received scant attention.

## Use expiration dates to ensure review

The Oregon Legislature has had success both by creating the Joint Committee on Tax Credits to consider the findings of evaluations and by placing statutory expiration dates on tax incentives. These “sunsets” encourage legislators to carefully consider the findings of evaluations, since lawmakers have to decide whether the programs should be extended, altered, or allowed to end. Under a 2009 law, virtually all of Oregon’s tax credit programs expire every six years unless lawmakers choose to renew them.<sup>79</sup> In each of the three legislative sessions in which lawmakers have considered expiring credits—2011, 2013, and 2015—the process has resulted in substantial changes.<sup>80</sup>

Sunsets have played a similar role elsewhere. In Washington, a 2012 evaluation showed that two tax incentives designed to encourage research and development spending were producing few jobs relative to their cost.<sup>81</sup> Based on that finding, a citizen commission that oversees Washington’s evaluations recommended that policymakers allow the programs to expire as scheduled Jan. 1, 2015.<sup>82</sup> Lawmakers followed that advice, saving the state tens of millions of dollars.<sup>83</sup> The state has also acted to apply sunset dates systematically: Under a 2013 law, any new tax expenditure expires after 10 years unless lawmakers extend it.<sup>84</sup>

Sunsets work best when paired with evaluations. Otherwise, lawmakers may lack the information they need to determine whether incentives should continue and, if so, in what form. Under Illinois law, any income tax credit, exemption, or deduction created since 1994 expires every five years unless lawmakers change the expiration date or exempt the program from the requirement.<sup>85</sup> Without evaluations to help guide their decisions, however, Illinois lawmakers approved a blanket extension of tax credits, exemptions, and deductions that were scheduled to expire in 2011, 2012, and 2013, rather than reviewing them individually in detail.<sup>86</sup>

## Communicate findings to executive agencies

Not all improvements to incentives require legislation. In many cases, evaluations have made a difference by identifying subtle changes that would improve the administration of incentives. If an evaluation showed that a state economic development agency was not adequately monitoring the performance of companies receiving incentives, for example, the agency could act on its own to improve its monitoring.

Some states have ensured that executive branch agencies consider the findings of evaluations so that administrative changes are more likely. Audit offices have had particular success in this regard, by allowing executive agencies to respond in writing to audit findings and recommendations. The audit offices then monitor whether their recommendations have been implemented, often writing follow-up reports. In Missouri and Wisconsin, for instance, this approach has helped economic development agencies improve the administration of incentives.<sup>87</sup>

Executive branch officials help oversee Oklahoma’s evaluation process through the state’s Incentive Evaluation Commission. The panel’s voting members are citizen appointees, but the heads of the Office of Management and Enterprise Services, the Department of Commerce, and the Oklahoma Tax Commission (or their designees) serve as nonvoting members. As a result, executive branch officials are involved upfront, as the Incentive Evaluation Commission identifies the goals of incentives and how to measure their success. Then, after private consultants produce evaluations, the commission votes on recommendations for improving the effectiveness of the programs.<sup>88</sup>

## Conclusion

Across the country, state policymakers are demanding high-quality information on the results of economic development tax incentives. More than half of states now have processes in place to regularly evaluate these programs. That represents impressive progress from just a few years ago, when a mere handful of states had them.

With better information, lawmakers can make better decisions. State officials are using evaluations to identify incentives that are working well and reform those that are not. As a result, evaluations are helping states save millions of dollars while achieving stronger economic results.

States still have work to do, however. More than 20 have not put an evaluation plan in place. Others could improve the rigor of their analyses or ensure that lawmakers consider the findings. Then, lawmakers will be able to design economic development policies that serve the needs of the state's budget, businesses, and workers.

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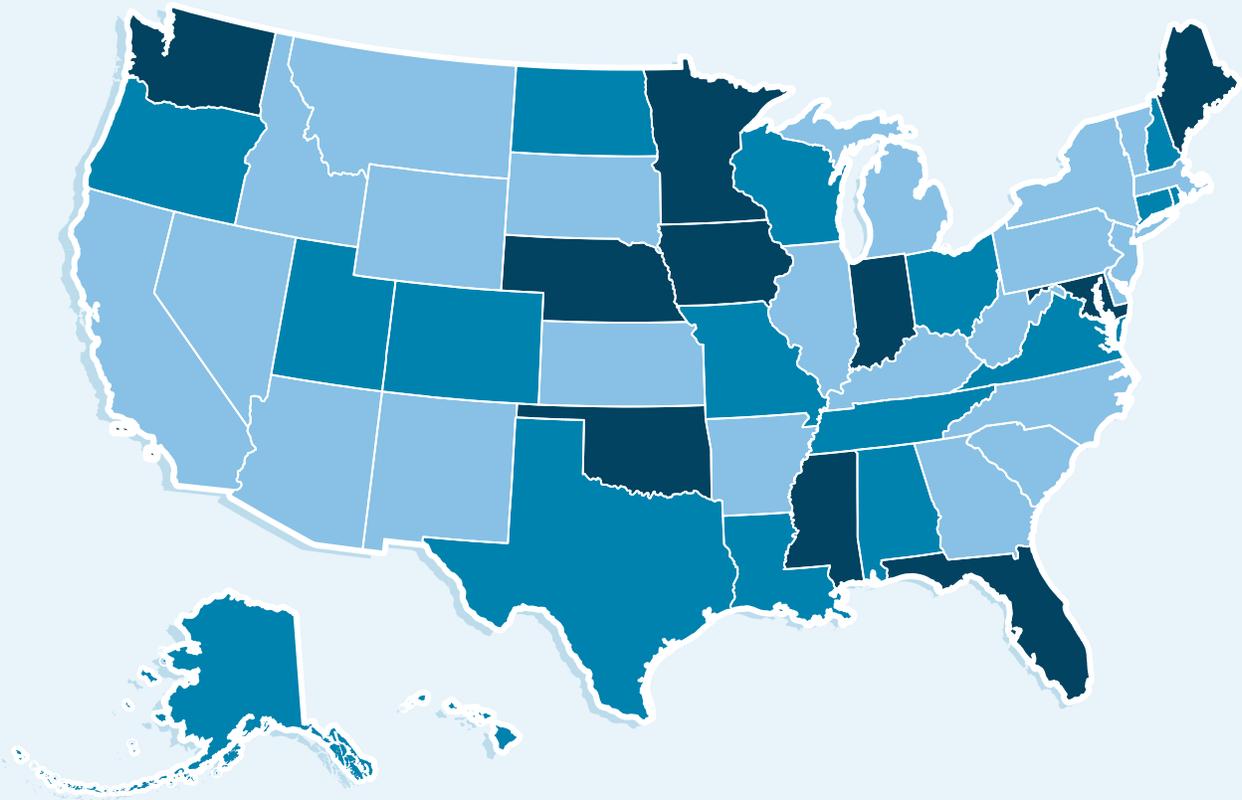
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# State Fact Sheets



# Alabama



## Key points:

- Alabama is **making progress** because the state has adopted a plan for regular evaluation of tax incentives.
- This push for better information comes as lawmakers are engaging in major debates over incentive policy.
- A Department of Revenue administrative rule could help ensure that the evaluations include consistent, high-quality information.

**Year enacted:** 2016.<sup>a</sup>

**Who evaluates:** State agencies that administer incentives.

**Length of review cycle:** Four years.

Lawmakers took an important step in 2016 toward regular, rigorous evaluations of tax incentives by passing legislation that requires evaluations on a four-year cycle. To ensure that lawmakers consider the findings, the House Ways and Means and Senate Finance and Taxation committees will hold hearings on the evaluations.<sup>b</sup>

One potential weakness of this law is that agencies are responsible for evaluating incentives they administer. Most states that have been successful at evaluating incentives have designated one state office to review all these programs to help ensure that the information is consistent and of high quality. Alabama's law attempts to ensure that the evaluations will be consistent by requiring the Department of Revenue to develop a standard format for the studies.<sup>c</sup>

In late 2016, the department introduced a proposed administrative rule laying out requirements for the evaluations. Under the rule, the evaluations would include a range of quantitative information and qualitative analysis on the goals, design, administration, and economic and fiscal impact of incentives. They would also estimate the extent to which incentives are successfully influencing business behavior, a key step for accurately measuring the results of the programs.<sup>d</sup>

In 2016, the Department of Revenue also hired a contractor to develop a set of best practices for evaluating incentives and to study four of the state's incentive programs.<sup>e</sup> Lawmakers requested the contract because they are debating major incentives and they have lacked reliable, independent information. For example, lawmakers allowed the state's Historic Rehabilitation Tax Credit to lapse after efforts to renew the program failed in 2016.<sup>f</sup> Supporters argued that the credit has helped boost redevelopment in Birmingham and other cities, but critics feared the state was making financial commitments it would struggle to afford.<sup>g</sup> Now, through the evaluation, lawmakers will have information on the results of the program as they consider whether to renew it.

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## Alaska



### Key points:

- Alaska is **making progress** because the state has adopted a plan for regular evaluation of tax incentives.
- The first evaluations, published in 2015, have already helped shape legislative conversations about incentives.
- Selectively studying major incentives in greater depth might lead to more detailed evaluations.

**Year enacted:** 2014.<sup>a</sup>

**Who evaluates:** Legislative Finance Division.

**Length of review cycle:** Six years.

In 2014, Alaska approved a law that requires evaluation of tax incentives on a six-year cycle. Under the law, the Department of Revenue works with other state agencies to report basic information on each incentive, including a description of the program, its goals, and its cost. Nonpartisan analysts in the Legislative Finance Division then use that information to assess whether the programs achieved their goals and to make policy recommendations.<sup>b</sup>

One strength of Alaska's law is how the review schedule is organized based on the administering agencies for the incentives. For example, the Legislative Finance Division studied every incentive administered by the Department of Commerce, Community, and Economic Development in 2015.<sup>c</sup> This approach ensures that lawmakers have information on similar programs in the same year, which helps them compare the results of incentives to one another.

The evaluations are already helping to shape conversations about incentives. For example, based on its evaluations, Legislative Finance recommended that lawmakers end some programs. Legislation to do that passed the Alaska House in 2015, but the Senate did not approve the bill.<sup>d</sup>

Alaska could improve the evaluation process by analyzing the state's largest incentives in more depth. Under the law, state officials are not only reviewing economic development tax incentives, but also studying hundreds of other "indirect expenditures," including tax credits, tax deductions, tax exemptions, and fee waivers—everything from fuel tax exemptions for charities to programs that allow seniors to receive free fishing licenses.<sup>e</sup> As a result, Legislative Finance reviewed more than 100 indirect expenditures in 2015. The report provided only limited rationales for its recommendations and generally did not include analysis of the economic impact of the programs.<sup>f</sup>

Producing detailed analysis of every indirect expenditure would be a herculean task. Other states have set priorities in their evaluation process to help deal with this challenge. Like Alaska, both Maine and Washington have evaluation laws that apply to hundreds of tax credits, exemptions, and deductions. In both states, some provisions receive full evaluations with detailed quantitative analysis, while others receive "expedited" reviews that rely more on descriptive information.<sup>g</sup> In 2016, Washington also exempted from evaluation dozens of tax preferences that the state determined were consistent with basic principles of tax policy such as avoiding double taxation.<sup>h</sup> Selectively studying major tax incentives in more depth would allow Alaska lawmakers to have the information they need to improve these programs.

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## Arizona



### Key points:

- Arizona is **trailing** other states because it lacks a well-designed plan to evaluate tax incentives.
- Since 2002, a legislative committee has reviewed tax credits, but the process has not proved effective for rigorously measuring economic impact or informing policy choices.
- Rigorous evaluations would help lawmakers know whether the state's \$100 million Research and Development (R&D) Credit is worth the investment.

While Arizona's evaluation law is one of the longest-standing in the country, it is not well-designed to ensure that economic development policymaking is informed by high-quality analysis.<sup>a</sup> In 2002, Arizona created the Joint Legislative Income Tax Credit Review Committee. Since then, however, the evaluation process has changed little. The committee typically meets once a year, in November or December, to recommend whether to continue, modify, or end each tax credit up for consideration that year. Each credit is reviewed every five years.

The limitations of the formal analysis provided to the committee are one weakness of Arizona's process. To inform the committee's work, nonpartisan legislative staff compiles a report on each credit. These reports include descriptive information, such as how much a program costs, how many taxpayers use it, and the program's history and purpose.<sup>b</sup> The staff, however, is limited in what it can say about possible improvements; in Arizona, legislative staff is not generally authorized to make policy recommendations.<sup>c</sup> While the evaluations have a brief section on the benefits of the credits, they have not included original, detailed economic analysis.

Other states have identified ways to improve the effectiveness of incentives through rigorous economic analysis and thorough examinations of the design and administration of the programs. In contrast, the Arizona committee has generally recommended simply to continue incentives or to eliminate them. Eliminating incentives is challenging in Arizona because the state constitution requires a two-thirds legislative supermajority for measures that increase revenue.<sup>d</sup>

Arizona lawmakers could strengthen the evaluation process by creating a clear mandate for evaluations with detailed economic analysis and policy-relevant conclusions. If lawmakers do not want legislative staff to make policy recommendations, there are other options. For example, Oklahoma has contracted with consulting firms to conduct evaluations.<sup>e</sup>

This type of more detailed information would be especially valuable for Arizona's largest incentives. For example, the state's R&D credit cost the state around \$100 million in 2014, the most recent year for which data are available.<sup>f</sup> In addition, companies are holding hundreds of millions of dollars in R&D credits that they could use in the future, since businesses are allowed to carry forward the credits for up to 15 years.<sup>g</sup> Rigorous evaluations would help lawmakers know whether the program is worth the investment and how it can be improved.

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# Arkansas



## Key points:

- Arkansas is **trailing** other states because it has not adopted a plan for regular evaluation of tax incentives.
- The state used to regularly study tax incentive programs but shifted the focus of the process because policymakers found the evaluations too technical and abstract.
- To re-establish an evaluation process, Arkansas could build capacity in the legislative audit office or contract with outside experts.

From 2005 to 2013, the Arkansas Legislative Audit Division was required by law to regularly evaluate the state's tax incentives.<sup>a</sup> The division contracted with academic economists to measure the impact of the programs.<sup>b</sup> Some of the reports included rigorous analysis but did not present the findings in a way that could easily be understood by policymakers, who found them too technical and abstract to provide valuable guidance.<sup>c</sup>

In response, lawmakers shifted the focus of the effort away from evaluating programs to studying individual projects that have received incentives.<sup>d</sup> The reports still yield valuable information but do not provide lawmakers with the policy-level information they need to decide which incentives should be part of the state's economic development portfolio and what form they should take.

One exception is a finding that the audit division included in its 2014 and 2015 reports: that incentives under the InvestArk Program produced weaker returns on the state's investment than other programs.<sup>e</sup> That conclusion was notable because InvestArk is the state's most expensive tax incentive, having cost more than \$170 million from 2011 to 2015.<sup>f</sup> Detailed programmatic evaluations could help confirm the audit's conclusion and offer recommendations for improving the effectiveness of incentive programs.

If Arkansas re-established a process for evaluation of incentive programs, the state could improve upon the past version in several ways. One option would be for the Legislative Audit Division to build the capacity to measure the impact of incentives in-house. In other states, such as Minnesota, Nebraska, and Washington, legislative auditors have proved that they can effectively evaluate the economic results of incentives. With their work overseen by legislative committees, these offices are often adept at providing clarity to lawmakers about their assumptions, findings, and recommendations.

Alternatively, states have had success contracting with outside experts to study incentives when the evaluators receive clear direction on what information will be most valuable to policymakers. For example, an Oklahoma commission identifies the goals of incentives and what evaluations should measure to determine whether those goals have been achieved. Then, the state contracts with consultants to complete the analysis.<sup>g</sup> That way, the consultants are more likely to provide the information lawmakers are seeking.

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## California



### Key points:

- California is **trailing** other states because it has not adopted a plan for regular evaluation of tax incentives.
- The state studies some incentives but not others, such as the \$1.5 billion-a-year Research and Development (R&D) Credit.
- Evaluations have shown their value by helping to inform lawmakers' decision to replace the state's Enterprise Zone Program.

Without a process for regular evaluation of all major tax incentives, California lawmakers lack consistent information on the results of these programs. Instead, some incentives have been studied in detail, while others have been largely ignored.

Over the years, various state offices and agencies—including the Legislative Analyst's Office, the Franchise Tax Board, and the state auditor—have periodically produced evaluations of incentives. The state has at times been proactive in requiring future evaluations for programs in laws creating or expanding them. For example, when policymakers expanded the state's film and television production tax credit in 2014, they included a requirement that the Legislative Analyst's Office evaluate the program's effectiveness and provide the results to key legislative committees by 2019.<sup>a</sup>

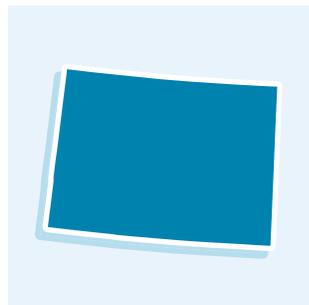
California's experience shows the value of high-quality information for improving the results of tax incentives. In 2013, lawmakers determined that the state's Enterprise Zone Program wasn't working as intended. The program was one of California's largest incentives, costing an estimated \$750 million in fiscal year 2014.<sup>b</sup> Despite this large commitment, a series of studies showed that the program was mostly moving jobs in the state without boosting net employment.<sup>c</sup> In response to these findings, lawmakers ended the Enterprise Zone Program and redirected the \$750 million to three new incentives designed to address the flaws.<sup>d</sup> The evaluations helped California make wholesale changes to its economic development strategy.

However, other incentives have been subject to far less scrutiny. For example, a 2016 state audit declared that it was "unable to determine the [R&D] credit's effectiveness because no state entity oversees or regularly evaluates it."<sup>e</sup> That represents a major gap in the information available to policymakers: At \$1.5 billion a year, the R&D credit is one of California's most expensive incentives.<sup>f</sup> If California lawmakers adopted a process for regular evaluation, the audit found, they would be more likely to have the information they need to determine whether incentives are achieving their goals.

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## Colorado



### Key points:

- Colorado is **making progress** because the state has adopted a plan for regular evaluation of tax incentives.
- The Office of the State Auditor will set a schedule for the evaluations in 2017.
- The law ensures that the perspectives of businesses and business organizations will be considered in the evaluations.

**Year enacted:** 2016.<sup>a</sup>

**Who evaluates:** Office of the State Auditor

**Length of review cycle:** Five years

In 2016, Colorado enacted bipartisan legislation requiring the Office of the State Auditor (OSA) to evaluate economic development tax incentives and other tax credits, exemptions, and deductions on a five-year cycle. The OSA is preparing to begin this work, with the first evaluations scheduled to be completed in 2018.<sup>b</sup>

By directing a legislative audit office to evaluate incentives, Colorado is following a proven approach: Washington's legislative auditor, for example, has produced detailed evaluations of the state's incentives for a decade.<sup>c</sup> While the OSA lacks experience measuring economic impact, Washington's experience shows that audit offices can successfully build this expertise over time.

Under the law, the OSA's first responsibility is to develop a schedule to ensure that all incentives are evaluated within the five-year period.<sup>d</sup> In doing so, it is important to consider the goals of Colorado's incentives. Other states, such as Alaska and Oregon, have scheduled programs with similar goals for evaluation in the same year.<sup>e</sup> That approach helps states compare the performance of incentives and identify those that are getting the best results. For incentive programs with statutory expiration dates, Colorado's law also requires the OSA to try to schedule the evaluations before these sunset dates.<sup>f</sup> That way, lawmakers will have information to determine whether incentives should be continued unchanged, modified, or allowed to end.

Colorado's legislation won support from business groups such as the state chapter of the National Federation of Independent Business, which agreed that tax incentives deserve more scrutiny.<sup>g</sup> The law ensures that the perspectives of businesses and business organizations will continue to be part of the evaluation process: The OSA is required to consult with beneficiaries of incentives for its analysis.<sup>h</sup> That requirement could allow OSA's evaluations to offer valuable insights on how incentives can serve the needs of Colorado businesses.

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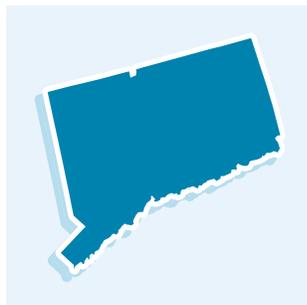
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## Connecticut



### Key points:

- Connecticut is **making progress** because the state has adopted a plan for regular evaluation of tax incentives.
- Connecticut's evaluations rigorously measure the economic impact of tax incentives.
- Without a strong connection between the evaluations and the policymaking process, lawmakers lack an impetus to consider the findings of the studies.

**Year enacted:** 2010.<sup>a</sup>

**Who evaluates:** Department of Economic and Community Development.

**Length of review cycle:** Three years.

Connecticut was one of the first states to begin producing regular evaluations that rigorously measured the economic impact of tax incentives. However, the studies have had little effect on incentive policy, in part because the state's approach lacks a strong connection between the evaluations and the policymaking process.

Connecticut's 2010 evaluation law requires the Department of Economic and Community Development (DECD) to evaluate business tax credits in a report published every three years.<sup>b</sup> DECD's evaluations take into account key considerations for measuring the economic results of incentives. High-quality evaluations consider that some businesses receiving incentives might have expanded even without the assistance. Connecticut's evaluations model the results of many incentives based on different scenarios for how much activity was caused by the incentives. By using money on incentives, states reduce the dollars available for other priorities—such as tax cuts or spending increases—that also could have some economic benefits. DECD's modeling treats the costs of tax credits as a reduction in state spending.<sup>c</sup>

While the evaluations provide a great deal of detail on the economic results, they offer less on the design and administration of incentives. Evaluations in other states, such as Missouri and Wisconsin, provide much more information on whether administering agencies are following proper procedures and whether the programs have been well-designed to achieve their intended goals.<sup>d</sup> DECD may not be the most appropriate agency to perform this type of analysis, because it is also responsible for promoting and administering many of the state's tax credits.

After DECD's reports are published, the agency simply has to deliver them to key officials in the legislative and executive branches. Many other states have designated legislative committees to consider the evaluations, hold hearings, and determine how to improve incentive policy. No legislative hearings were held on DECD's most recent evaluation.<sup>e</sup>

In 2016, legislation was proposed to address the weaknesses of the current system. Under the bill, a nonpartisan legislative office with experience studying the details of government initiatives would have taken over the lead role in conducting the evaluations, while DECD would have continued to provide assistance with economic modeling. The legislation also would have required two legislative committees to hold hearings on the evaluations.<sup>f</sup> The bill passed both houses of the Legislature but was vetoed by Governor Dannel Malloy (D),

who said he preferred that DECD continue as the evaluation office. His veto message also said supporters of the legislation could work with DECD to implement other aspects of the bill, even without statutory changes.<sup>8</sup>

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## Delaware



### Key points:

- Delaware is **trailing** other states because it lacks a well-designed plan to evaluate tax incentives.
- While the Division of Revenue has published analyses of tax incentives for many years, the process has not proved effective for rigorously measuring economic impact or informing policy choices.
- Lawmakers may want to consider an evaluation process that includes grant and loan programs such as the Delaware Strategic Fund, one of the state's most expensive incentives.

Every odd-numbered year, Delaware's Division of Revenue publishes a report on tax expenditures with data on the costs of incentives and assessments of whether they are achieving their goals.<sup>a</sup> These reports contain valuable analysis of incentives on a conceptual level, but they lack in-depth economic analysis or policy recommendations. For example, the authors discuss whether tax expenditures are consistent with principles of well-designed tax codes, such as treating similar taxpayers equally and avoiding undue administrative complexity. The reports also acknowledge that determining the extent to which incentives are changing business behavior is important for measuring their results, but they do not offer quantitative analysis of the effectiveness of the programs.<sup>b</sup> Delaware lawmakers would benefit from making improvements to the evaluation process.

Delaware also does not require lawmaker action once the Division of Revenue's reports are released. Other states, such as Iowa, Maryland, and Washington, hold legislative hearings on new tax incentive evaluations.<sup>c</sup> Establishing a process to involve lawmakers after evaluations are published would increase the likelihood that policy improvements follow.

While the Division of Revenue's evaluations include all tax expenditures, they do not analyze programs such as the Delaware Strategic Fund, a grant and loan program that is one of the state's most expensive incentives. In 2010, Delaware used the fund to provide \$21.5 million in incentives to Fisker Automotive to build a manufacturing plant in the state. Facing financial problems, however, the company never built the plant. Fisker went bankrupt in 2013, and Delaware has been unable to reclaim the bulk of the incentives.<sup>d</sup>

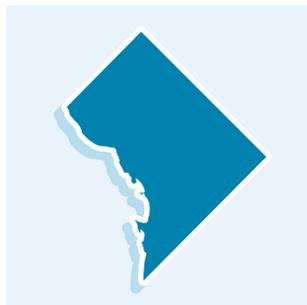
Despite that setback, economic development officials have argued that the Strategic Fund is generally working well.<sup>e</sup> An evaluation could confirm that conclusion or offer ideas for potential improvements. Designing an evaluation process that includes regular, detailed analyses of both tax and cash incentives would provide policymakers with consistent, high-quality information.

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## District of Columbia



### Key points:

- The District of Columbia is **making progress** because it has adopted a plan for regular evaluation of tax incentives.
- The first evaluations under the law, published in 2015, included valuable information on the goals and design of incentives.
- Holding City Council hearings on the evaluations would provide a venue for lawmakers to consider the findings.

**Year enacted:** 2014.<sup>a</sup>

**Who evaluates:** Office of the chief financial officer.

**Length of review cycle:** Five years.

When a 2014 law tasked analysts in the District’s office of the chief financial officer (CFO) with evaluating tax incentives on a five-year cycle, they did not start small. The first evaluation, published in late 2015, reviewed 31 housing tax expenditure programs and 28 specific housing developments for which the City Council had authorized tax incentives.<sup>b</sup>

The study included a variety of useful information on these tax incentives, detailing the goals of each and the logic behind them. It discussed whether the incentives were consistent with principles of a well-designed tax system, such as treating similar taxpayers equally. The evaluation also recommended improvements to oversight of housing programs and the data available for analyzing them. For example, the authors found that city agencies were not consistently monitoring whether housing developments met required affordability standards and recommended that policymakers clarify who is responsible for this task.<sup>c</sup>

Analysts in the CFO’s office say they plan to expand their analysis of the economic results of incentives in future studies. In the first report, they lacked the time and data to go in-depth on the programs’ economic impact.<sup>d</sup>

After studying the city’s environmental tax expenditures, the office will review economic development incentives next.<sup>e</sup> By reviewing similar tax incentives in the same year, the District is following an approach that has worked well elsewhere, such as in Oregon and Washington.<sup>f</sup> This strategy allows jurisdictions to compare the results of various programs and identify which are most effective.

The CFO’s office is working to enhance the tax data it collects, a step that the housing study recommended to improve future evaluations. So far, however, the council and other city agencies have not acted on the recommendations in the evaluation.<sup>g</sup> By law, many states, including Maryland and Washington, hold legislative hearings on new tax incentive evaluations, but the District’s statute lacks such a provision.<sup>h</sup> Holding council hearings on the evaluations would provide a venue for lawmakers to consider the findings, making improvements to incentives a more likely outcome.

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## Florida



### Key points:

- Florida is **leading** other states because it has a well-designed plan to regularly evaluate tax incentives, experience in producing quality evaluations that rigorously measure economic impact, and a process for informing policy choices.
- Two legislative offices with complementary skill sets provide valuable information on the results of incentives.
- Lawmakers allowed the Enterprise Zone Program to expire in 2015, a decision that was consistent with the findings of evaluations and will save the state tens of millions of dollars in coming years.

**Year enacted:** 2013.<sup>a</sup>

**Who evaluates:** Office of Economic and Demographic Research and Office of Program Policy Analysis and Government Accountability.

**Length of review cycle:** Three years.

In 2013, the Florida Legislature adopted a law tasking two legislative staff offices with evaluating economic development incentives on a three-year cycle, an approach that has made the state a national leader in tax incentive evaluation.<sup>b</sup> One reason for the success is that these two—the Office of Economic and Demographic Research (EDR) and the Office of Program Policy Analysis and Government Accountability (OPPAGA)—have complementary skill sets. EDR provides sophisticated economic analysis to lawmakers, and OPPAGA conducts program performance evaluations.

Under the law, EDR uses economic modeling to study the impact of incentives, analysis that takes into account key considerations. In a 2014 evaluation, for example, EDR studied the net results of incentives, considering both their economic benefits and the economic losses of having fewer state dollars available for other purposes.<sup>c</sup> The evaluations have also analyzed whether incentives are likely to influence employer decisions. For example, a 2015 evaluation of incentives for the defense industry questioned the effectiveness of the programs, arguing that federal decisions are likely more important for determining where military bases and defense contractors locate.<sup>d</sup>

OPPAGA's qualitative research work complements EDR's quantitative analysis. The office describes how the programs function in detail. OPPAGA's staffers also often interview program participants and discuss their experiences with the incentives. In some instances, the office provides recommendations for improving administration of the programs.<sup>e</sup>

The offices present their findings to lawmakers at committee hearings, offering legislators opportunities to consider whether changes to incentives are warranted. The analysis proved useful to policymakers when they were considering renewing Florida's Enterprise Zone Program, which was set to expire at the end of 2015. EDR showed that the program provided a weaker return on investment than other incentives. One reason was that the program was mostly moving economic activity from place to place within Florida, rather than growing the state economy.<sup>f</sup> OPPAGA's analysis also showed that the program overall was not meeting its goals.<sup>g</sup> Ultimately,

lawmakers allowed the program to expire—a decision that will save Florida tens of millions of dollars in coming years.<sup>h</sup>

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## Georgia



### Key points:

- Georgia is **trailing** other states because it has not adopted a plan for regular evaluation of tax incentives.
- The state has provided hundreds of millions of dollars in film tax credits but has not rigorously studied the results of the program.
- Lawmakers could give Georgia State University's Fiscal Research Center responsibility for evaluating incentives.

In recent years, a number of blockbuster movies have been filmed in Georgia, from “Captain America: Civil War” to “Anchorman 2: The Legend Continues.”<sup>a</sup> These productions, however, have come at a price. From 2009 through 2014, film tax credits cost the state more than \$900 million.<sup>b</sup> The costs have been increasing: In fiscal year 2017, the program is expected to cost \$376 million.<sup>c</sup> While many states have used incentives to try to attract movie productions over the last 15 years, Georgia’s program offers some of the most favorable terms in the country.<sup>d</sup>

Despite the significance of the program, Georgia lacks a process for evaluating the film tax credit and other incentives. Lawmakers have made a series of major decisions on incentive policy in recent years, including expanding the historic preservation tax credit, creating a sales tax exemption designed to lure the Super Bowl to Atlanta, and ending a tax credit for the purchase of low-emission vehicles.<sup>e</sup> Evaluations could help lawmakers determine how well these policies are working for the state’s budget and economy, and for businesses too.

Making the film tax credit work as well as possible for businesses has been an area of concern. Filmmakers have complained about a lack of local workers to staff their productions—which state officials have attempted to address through expanded workforce training programs.<sup>f</sup> An evaluation could provide independent information on whether those efforts are succeeding.

The Fiscal Research Center, a think tank at Georgia State University that regularly provides policy analysis to state officials, offers detailed descriptive information on incentives but does not measure their effectiveness. Experts at the center compile the state’s annual tax expenditure report, which includes estimates of the fiscal cost of each tax credit, exemption, and deduction in Georgia.<sup>g</sup> They also published a 2016 report that described the film tax credit and placed it in a national context.<sup>h</sup>

Other states have been able to take advantage of valuable institutions similar to the Fiscal Research Center as part of their evaluation processes. For example, under a 2014 Mississippi law, a university-based research center evaluates incentives every four years.<sup>i</sup> Georgia’s center, however, lacks a similar mandate from the state to regularly assess the economic impacts of incentives and to draw conclusions about their results.

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## Hawaii



### Key points:

- Hawaii is **making progress** because the state has adopted a plan for regular evaluation of tax incentives.
- The Legislature’s audit office will publish the first evaluations in 2018.
- To produce high-quality analyses, officials will need to overcome data collection challenges.

**Year enacted:** 2016.<sup>a</sup>

**Who evaluates:** Office of the auditor.

**Length of review cycle:** 5 years for some programs, 10 years for others.

In 2016, Hawaii enacted legislation requiring the Office of the Auditor to periodically review tax exemptions, exclusions, and credits.<sup>b</sup> The first evaluations will be released in 2018. In a place where tax incentives have caused serious fiscal challenges, the information in these studies stands to help lawmakers ensure that these programs are serving the needs of the state’s budget and economy.

Other states have had success assigning legislative audit offices to evaluate tax incentives, including Nebraska and Washington.<sup>c</sup> Hawaii’s audit office has the right experience to follow these examples. In 2012, for example, the office documented problems with the design and administration of the state’s tax incentives for high-tech businesses.<sup>d</sup>

That audit and a follow-up report in 2015 showed that the state faces significant budget uncertainty from the high-tech incentives. Although lawmakers had closed the program to new participants years earlier, the 2015 report found that Hawaii had an ongoing obligation of hundreds of millions of dollars from the high-tech incentives, with little clarity as to when or if businesses might claim them.<sup>e</sup> Renewable energy tax credits have also caused budget challenges for Hawaii in recent years, as costs increased rapidly without any explicit decision by policymakers to expand the program.<sup>f</sup> Maryland has used evaluations to analyze whether adequate protections are in place to avoid these types of challenges—a model Hawaii could follow.<sup>g</sup>

Data collection could be a roadblock to evaluation in Hawaii. The Department of Taxation faces technological challenges collecting data and must comply with strict state taxpayer confidentiality laws that are more rigid than the requirements in federal law.<sup>h</sup> These limitations have created barriers to evaluation.<sup>i</sup>

Other states have worked to overcome similar challenges. For example, beginning with legislation enacted in 2016, Nebraska has tried to make it easier for evaluators to receive complete, timely data from the Nebraska Department of Revenue while protecting sensitive information.<sup>j</sup> Nebraska’s experience shows that designing effective evaluation systems is often an iterative process. Even if Hawaii’s first evaluations lack perfect information with which to analyze incentives, the state can improve the process over time.

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## Idaho



### Key points:

- Idaho is **trailing** other states because it has not adopted a plan for regular evaluation of tax incentives.
- When lawmakers created a new incentive in 2014, they required annual evaluations of the program.
- These evaluations could serve as a first step to a consistent process for studying incentives.

Most incentives in Idaho are not reviewed regularly. However, when state lawmakers created a tax credit called the Tax Reimbursement Incentive in 2014, they also required annual evaluations of the program's effectiveness.<sup>a</sup>

The idea behind the incentive was to broaden Idaho's economic development portfolio. The state had previously focused heavily on providing public infrastructure to attract businesses. In contrast, the Tax Reimbursement Incentive rewards job creation—an approach that economic development officials hope will help Idaho land businesses without large infrastructure needs, such as high-tech firms.<sup>b</sup>

To determine whether this approach is working, the law tasks the Department of Commerce with measuring the economic impact of the incentive and making policy recommendations. As part of the evaluations, Commerce must also hire an auditor to assess whether the department is administering the program effectively.<sup>c</sup> In adopting these requirements, the state will scrutinize what is likely to quickly become one of Idaho's largest incentives. The state authorized \$32 million in tax credits in the program's first year of operation.<sup>d</sup>

Despite the quick pace of authorizations, no businesses had been issued any tax credits when the first edition of the evaluation was published in 2015.<sup>e</sup> (Businesses must meet their job creation commitments before the credits are issued.) As a result, the evaluations are a work in progress. As more data become available, the studies will need to rigorously measure economic impact, taking into account key factors such as the extent to which the incentives influenced business choices and the net effects for the state economy. If they do that, the evaluations will provide valuable information to policymakers and could also serve as a first step toward a regular evaluation process for all the state's major tax incentives.

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## Illinois



### Key points:

- Illinois is **trailing** other states because it has not adopted a plan for regular evaluation of tax incentives.
- An Illinois law that requires many income tax credits, exemptions, and deductions to expire every five years could be a starting point for establishing regular reviews of the programs.
- The staff of the state's Commission on Government Forecasting and Accountability could potentially evaluate incentives effectively.

In recent years, severe state budget challenges have formed the backdrop for discussions of incentives in Illinois. In 2015, Governor Bruce Rauner (R) suspended new approvals for companies to participate in the Economic Development for a Growing Economy (EDGE) tax credit, one of the state's largest business incentives, citing the state's budget deficit.<sup>a</sup> (EDGE has since been reinstated.<sup>b</sup>)

The same year, an investigation by the *Chicago Tribune* found that state officials lacked information on whether the EDGE credit led to net job creation in the state. One problem was that the program required businesses to increase employment at specific locations to receive the credits but did not prevent them from shifting jobs from other areas of the state to do so.<sup>c</sup> Policymakers recognized these shortcomings and began requiring companies to increase their statewide employment to qualify, but the state has not yet implemented a regular evaluation process that could identify similar flaws in incentive programs before they become serious problems.<sup>d</sup>

Illinois could potentially build on a long-standing state law that requires any income tax credit, exemption, or deduction created since 1994 to expire every five years unless lawmakers choose to change the date or exempt it from the requirement.<sup>e</sup> In other states, such as Oregon, these "sunsets" have led to incentive improvements when used in tandem with evaluations. The sunsets provide an impetus for lawmakers to review incentives and determine whether they should be extended, modified, or allowed to expire, while the evaluations offer objective analysis to help inform those choices.<sup>f</sup> Without evaluations to help guide their decisions, however, Illinois lawmakers approved a blanket extension of tax credits, exemptions, and deductions that were scheduled to expire in 2011, 2012, and 2013 rather than reviewing them individually in detail.<sup>g</sup>

If Illinois were to begin regularly evaluating the effectiveness of its incentives, the staff of the state's Commission on Government Forecasting and Accountability (COGFA) could potentially perform the analysis. The commission is a bipartisan organization overseen by members of each legislative chamber. It is charged with conducting research and providing information to lawmakers on a variety of economic issues affecting the state.<sup>h</sup> COGFA has published an overview of Illinois tax incentives and presented its findings to the Legislature in the past but has not studied the effectiveness of individual programs.<sup>i</sup>

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## Indiana



### Key points:

- Indiana is **leading** other states because it has a well-designed plan to regularly evaluate tax incentives, experience in producing quality evaluations that rigorously measure economic impact, and a process for informing policy choices.
- Based on the findings of evaluations, lawmakers have eliminated some incentives that provide a poor return on investment.
- In 2017, the state is scheduled to evaluate the Economic Development for a Growing Economy (EDGE) tax credit, one of the state's largest incentives.

**Year enacted:** 2014.<sup>a</sup>

**Who evaluates:** Legislative Services Agency.

**Length of review cycle:** Five years.

In spring 2014, Indiana lawmakers approved legislation requiring evaluation of tax incentives on a five-year cycle.<sup>b</sup> Perhaps no other state has achieved such rapid results from a new evaluation process. By the end of the year, the nonpartisan staff of the Legislative Services Agency (LSA) had completed a rigorous evaluation that showed two small incentives were providing a poor return on investment.<sup>c</sup> Lawmakers eliminated those incentives in 2015.<sup>d</sup> Since then, the LSA has continued to produce high-quality studies that are helping to inform policymaker debates over tax incentives—making Indiana a national leader in this area.

Using a mix of common sense and quantitative analysis, the LSA's researchers have estimated how much taxpayer activity can be attributed to incentives—a key step for measuring their economic impact. For example, they found that a tax deduction saved taxpayers only 2.3 percent on the cost of installing solar-powered roof vents or fans. For a \$900 installation project, that would mean a savings of just \$21. The small savings were one reason the evaluation determined that the deduction was an “ineffective tool to encourage project spending that would otherwise not occur.” In addition, the evaluation used estimates from academic literature on how responsive consumers are to changes in the cost of energy efficiency projects. The academic research showed the 2.3 percent cost reduction would not significantly affect taxpayer decisions. In 2015, lawmakers eliminated the deduction based on these findings.<sup>e</sup>

Indiana policymakers have continued to work to improve the evaluation process. Legislation in 2015 provided the LSA with more flexibility to determine what information should be included in the studies and to set the evaluation schedule.<sup>f</sup> The LSA is using this flexibility to evaluate incentives with similar purposes in the same year—an approach that has helped other states, such as Oregon and Washington, compare the results of programs and ensure that they are coordinated effectively.<sup>g</sup>

In 2017, the LSA is scheduled to evaluate the EDGE tax credit.<sup>h</sup> Through this program, the state has committed hundreds of millions of dollars in incentives in recent years.<sup>i</sup> Given the LSA's track record, lawmakers should soon have high-quality information on one of the state's largest incentives.

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## Iowa



### Key points:

- Iowa is **leading** other states because it has a well-designed plan to regularly evaluate tax incentives, experience in producing quality evaluations that rigorously measure economic impact, and a process for informing policy choices.
- The Department of Revenue's studies include a wealth of information on each tax credit's history, design, cost, and performance.
- Holding more frequent hearings on the evaluations could help lawmakers determine how to use the findings to improve incentive policy.

**Year enacted:** 2010.<sup>a</sup>

**Who evaluates:** Department of Revenue.

**Length of review cycle:** Five years.

By law, the Iowa Legislature's Tax Expenditure Committee reviews tax incentives on a five-year rotating basis.<sup>b</sup> These reviews are informed by studies from economists within the Department of Revenue—evaluations that have several notable strengths.<sup>c</sup>

Revenue's studies include a wealth of information on each tax credit's history, design, cost, and performance. Many of the reports also include comparisons between Iowa credits and similar programs elsewhere—with 50-state data on which states have equivalent programs. Several of the reports have also used innovative approaches to isolate the impact of incentives. For example, a 2015 study of the Beginning Farmer Tax Credit compared beneficiaries of the program to a control group of farmers who did not participate to help estimate to what extent the incentive was helping farmers succeed.<sup>d</sup>

To assist with the evaluations, Revenue convenes advisory panels, which often include a mix of agency officials, academics, and representatives from relevant industry associations. These panels have helped Revenue staff understand the programs, identify sources of data, and consider various perspectives on the incentives.<sup>e</sup>

These evaluations are produced for the Tax Expenditure Committee, which typically meets once a year in November or December to discuss the incentives that are up for review and to receive testimony from Revenue, executive branch agencies, and other interested parties.<sup>f</sup> On occasion, this process has led to efforts to improve Iowa's tax credits. For example, in 2013, Revenue's analysis showed that a recently adopted administrative rule was significantly restricting eligibility for the state's Child and Dependent Care Tax Credit.<sup>g</sup> At a hearing, members of the committee discussed reversing the new rule.<sup>h</sup> In 2014, lawmakers enacted a bill to do just that.<sup>i</sup>

Despite this example, however, policy changes to incentives from the committee's work have been rare. One reason is that for all their analytical rigor, Revenue's studies do not typically include clear conclusions on how to improve incentive programs; like other state tax-collecting agencies around the country, Revenue's staff does not typically make policy recommendations.

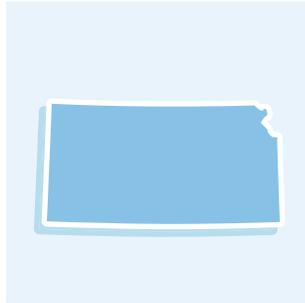
That is not an insurmountable obstacle, however. Other states have found that when lawmakers dig into the details of incentive programs, they can draw valuable conclusions about policy even when evaluations do not

include specific recommendations. One option is for Iowa to follow the lead of states such as Oregon and North Dakota, where committees reviewing tax incentives have held frequent hearings to allow lawmakers to study these programs in much more detail.<sup>j</sup>

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# Kansas



## Key points:

- Kansas is **trailing** other states because it has not adopted a plan for regular evaluation of tax incentives.
- The Legislative Division of Post Audit has conducted ad hoc evaluations in recent years and could potentially study incentives regularly.
- Evaluations could help inform the public resources invested in attracting companies to move into Kansas from just over the border with Missouri.

The professional staff of the Legislative Division of Post Audit (LPA) has often evaluated tax incentives in recent years. However, these studies have been the result of ad hoc requests from lawmakers. There is no structure in place to ensure regular and rigorous evaluations of the state's incentives.<sup>a</sup>

The most recent LPA evaluations were a series of three studies published in 2013 and 2014 that centered on analyzing which of the state's economic development programs are most effective.<sup>b</sup> These studies have helped inform legislative action. For example, a 2013 evaluation argued that the state Department of Commerce had provided more incentives under the Promoting Employment Across Kansas (PEAK) program than were permitted by statute.<sup>c</sup> In response, Commerce said it had interpreted PEAK's incentive cap differently.<sup>d</sup> In 2014, the lawmakers passed legislation to clarify the amount of incentives Commerce was allowed to provide under the program.<sup>e</sup>

Given the LPA's experience evaluating incentives, the office would be well-suited to studying the programs regularly should lawmakers create a process to do so. The LPA has a record of carefully studying whether government programs are operating efficiently and identifying potential improvements. Many legislative audit offices lack experience measuring economic impact, but the LPA worked with an outside consultant to perform analysis of the economic results of incentives in 2014—a model that could prove effective for future evaluations.<sup>f</sup>

In Kansas, discussions of incentive policy often focus on the Kansas City "border war." Both Kansas and Missouri have used incentives to lure companies across the state line—sometimes offering millions of dollars in incentives to persuade businesses to move just a few miles. Many policymakers and business leaders in both states view this competition as counterproductive and have tried to negotiate a truce, but so far they have not succeeded.<sup>g</sup> While evaluations may not be able to end the border war on their own, they could help inform lawmakers' consideration of the issue. A 2014 LPA evaluation showed that even if Kansas had not lured Missouri companies across the border, Kansas still would have received some tax revenue and economic benefits from these businesses' activities.<sup>h</sup>

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# Kentucky



## Key points:

- Kentucky is **trailing** other states because it has not adopted a plan for regular evaluation of tax incentives.
- Evaluations could help determine the effectiveness of the Kentucky Business Investment Program, under which officials have approved hundreds of millions of dollars in incentives.
- The Cabinet for Economic Development has built a rich database on incentives, which could prove valuable if the state were to begin evaluating the programs.

Kentucky hired a private economic consulting firm to produce a comprehensive evaluation of the state's economic development incentives in 2012. This impressive document included rigorous analysis of the impact of the state's economic development programs as well as recommendations for improving their effectiveness.<sup>a</sup> That one-time study, however, has not been followed by the creation of an ongoing process for evaluation of the state's incentives.

If Kentucky established regular evaluations, as many other states have done, it would be able to draw on a rich database built and maintained by the Cabinet for Economic Development. The database includes the names and locations of businesses with incentive contracts, their average wages, whether they've met job creation commitments, and the costs of the incentives.<sup>b</sup> The database serves a variety of audiences, including businesses, local economic development organizations, and journalists.<sup>c</sup> Evaluators could aggregate and analyze the data on a programmatic level and draw conclusions about the effectiveness of incentives.

In 2009, about the same time Kentucky created the database, lawmakers also shifted the state's approach to economic development, eliminating several incentives and creating others. The most significant change was the creation of the performance-based Kentucky Business Investment (KBI) Program.<sup>d</sup> Under the program, the state enters into contracts of up to 15 years with businesses to provide incentives so long as they meet job creation, wage, and investment targets.<sup>e</sup> The state has approved hundreds of millions of dollars in KBI incentives—costs that will gradually affect the state budget if businesses fulfill their commitments.<sup>f</sup> Regular evaluations of KBI and other Kentucky incentives could help show whether these programs are worth the price and identify ways they can work better.

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## Louisiana



### Key points:

- Louisiana is **making progress** because the state has adopted a plan for regular evaluation of tax incentives.
- The evaluations have not included rigorous economic analysis or detailed examinations of incentives.
- To improve, lawmakers could consider tasking one office that possesses both independence and relevant expertise with evaluating incentives.

**Year enacted:** 2013.<sup>a</sup>

**Who evaluates:** State agencies that administer incentives.

**Length of review cycle:** One year.

Louisiana approved legislation in 2013 that requires state agencies to annually evaluate the incentives they administer.<sup>b</sup> However, the evaluations have generally included only a few paragraphs of discussion of each incentive. While the reviews sometimes provide useful insights on the design of the programs, they do not generally offer original economic or fiscal analysis.<sup>c</sup> Louisiana’s legislative auditor has highlighted the weaknesses of the studies, finding, for example, that only 33 of 71 evaluations in 2016 complied with a requirement to include information on the incentive’s return on investment.<sup>d</sup>

Louisiana lawmakers could improve the process in several ways. Six agencies evaluate incentives, with Louisiana Economic Development (LED)—the state agency charged with recruiting and growing businesses—and the Department of Revenue responsible for the bulk of the studies.<sup>e</sup> Having agencies study the incentives they administer potentially puts the agencies in an awkward position, as they are asked to critically analyze programs they are simultaneously promoting. In contrast, many states have tasked one office that possesses both independence and relevant expertise with evaluating incentives. Independent professional staff with the capacity to produce rigorous economic and fiscal impact analysis could provide Louisiana lawmakers with more meaningful, consistent information.

Many states have also set up a rotating cycle for evaluation, rather than attempting to study every incentive in a single year. This approach allows analysts and lawmakers to focus on a subset of incentives each year.

Due to their shortcomings, the evaluations have had little influence on debates over incentive policy that have roiled the Louisiana Legislature in recent years. With the state facing severe budget challenges, lawmakers curtailed many of the state’s incentives in 2015. Several of the changes, however, were temporary. For example, the state instituted a three-year cap on claims under its film tax credit, which cost Louisiana about \$250 million a year at its peak.<sup>f</sup> As these temporary changes expire, lawmakers will need high-quality information to guide their decisions.

When Louisiana lawmakers have had good information, they have proved they will use it. A 2010 LED evaluation of the Enterprise Zone Program found that providing incentives to restaurants and retailers under the program resulted in weaker job creation than providing incentives to manufacturers.<sup>g</sup> Subsequent LED analyses echoed

those findings.<sup>h</sup> Lawmakers approved legislation in 2015 that ended the ability of restaurants and retailers to participate in the program, a change that stands to make the Enterprise Zone Program a more effective job creation tool, while saving the state millions of dollars.<sup>i</sup> By improving the state’s evaluation process, Louisiana lawmakers will be more likely to have the information they need to achieve similar outcomes in the future.

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## Maine



### Key points:

- Maine is **leading** other states because it has a well-designed plan to regularly evaluate tax incentives, experience in producing quality evaluations that rigorously measure economic impact, and a process for informing policy choices.
- By tasking a legislative program evaluation office with evaluating incentives, Maine's law follows a proven approach.
- In the first round of evaluations, the state is studying the New Markets Capital Investment Program, which is subject to much debate.

**Year enacted:** 2015.<sup>a</sup>

**Who evaluates:** Office of Program Evaluation and Government Accountability.

**Length of review cycle:** Six years.

In 2013, as Maine struggled to balance its budget, lawmakers charged a special Tax Expenditure Review Task Force with recommending tax credits, exemptions, and deductions that could be reduced or eliminated to save \$40 million. Finding those savings proved exceptionally difficult, however, for a simple reason: As the task force itself acknowledged, without evaluations in place, they had little basis for determining which tax expenditures were expendable.<sup>b</sup> The experience drove home for lawmakers the need for better information, something that stands to be provided by a 2015 law requiring the Legislature's Office of Program Evaluation and Government Accountability (OPEGA) to regularly evaluate tax incentives and other credits, exemptions, and deductions.<sup>c</sup>

By tasking OPEGA with evaluation, Maine is following a proven approach. Legislative program evaluation or audit offices in Washington and Florida have been producing high-quality evaluations for years. With a nonpartisan staff experienced at studying government programs in-depth, OPEGA is well-positioned to do the same.

OPEGA's first evaluation under the process, published in 2017, examined the New Markets Capital Investment Program. The evaluation included an examination of the program's goals and whether they have been achieved, rigorous analysis of its economic impact, and detailed recommendations for improving its effectiveness.<sup>d</sup>

This information should prove valuable as lawmakers consider the future of the New Markets program, which has been the subject of controversy. A *Maine Sunday Telegram* investigation found that an out-of-state private equity firm had made one-day loans to a paper mill to artificially increase the size of its investment under the program and thereby increase its haul of tax credits. Even though the mill ceased operations in 2014, the state still had an obligation of \$16 million in credits.<sup>e</sup> The state authority that oversees the New Markets program has since banned one-day loans.<sup>f</sup>

Maine's 2015 law has a broad scope, requiring evaluation not only of economic development tax incentives, but also other tax expenditures. However, the law allows legislators to set priorities to make OPEGA's workload more manageable. Some programs receive "full evaluations" with detailed analysis of their empirical results, while others receive "expedited reviews" that focus more on their goals and whether they're still relevant.<sup>g</sup> Using similar tiers of review has worked well for Washington.

One weakness of Maine’s law is that the frequency with which each tax expenditure must be evaluated is not specified. The schedule for evaluations approved by the Legislature’s Government Oversight Committee in 2015, however, requires each tax expenditure to be evaluated once over the next six years.<sup>h</sup> By maintaining that schedule for review, lawmakers will ensure that they have up-to-date information on each tax incentive.

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## Maryland



### Key points:

- Maryland is **leading** other states because it has a well-designed plan to regularly evaluate tax incentives, experience in producing quality evaluations that rigorously measure economic impact, and a process for informing policy choices.
- Lawmakers have used the evaluations to make improvement to incentives, including a tax credit for rehabilitating historic buildings.
- Since new incentives are not automatically added to Maryland's review schedule, lawmakers will need to update the schedule periodically to ensure that it remains comprehensive.

**Year enacted:** 2012.<sup>a</sup>

**Who evaluates:** Department of Legislative Services.

**Length of review cycle:** Seven years.

Under a 2012 law, the nonpartisan professional staff of Maryland's Department of Legislative Services (DLS) produces detailed studies of tax credits each year.<sup>b</sup> These evaluations are helping lawmakers improve the effectiveness of the state's incentives.

For example, on the basis of an evaluation, Maryland lawmakers decided in 2016 to continue and improve a tax credit for rehabilitating historic buildings. The evaluation described the incentive as a model program, noting that lawmakers had put in place key protections to ensure that the cost would be predictable from year to year. But the report also pointed out ways the tax credit could work better. For example, the evaluation noted flaws in the scoring system state officials used to determine which commercial projects would qualify for the incentives.<sup>c</sup> In response, lawmakers extended the program for five years—it had been scheduled to expire in 2017—while also adjusting the scoring system.<sup>d</sup>

The historic rehabilitation report is one of several high-quality evaluations DLS has released under the law. One strength of the studies is that they draw clear policy-relevant conclusions. For example, an evaluation of the state's Enterprise Zone Program—designed to assist distressed areas—showed that many zone residents lacked the skills required for the jobs, making it unlikely that the incentive alone could help them find employment. The report recommended using workforce training programs as one option to address this issue.<sup>e</sup>

DLS has also provided valuable economic impact analysis of incentives. When using economic modeling to study the state's film tax credit, for instance, DLS compared the benefits of the credit to the economic costs of paying for it—based on the idea that money used on incentives is not available for other government purposes.<sup>f</sup>

By law, the studies are considered by legislators. The evaluation law established a legislative committee that is responsible for holding hearings to review evaluation drafts published by DLS. The committee also receives testimony from the public and discusses the recommendations in each evaluation to determine whether a credit should be continued with or without changes, or terminated.<sup>g</sup>

While the state has proved it can produce strong evaluations that can drive policy change, the scope of Maryland's evaluation process could still be improved. Many states automatically add new tax incentives to their evaluation schedule, but Maryland does not. Instead, the law requires evaluation of a specific set of credits. Lawmakers added several credits to the review schedule under a separate law passed in 2016, but the state will still need to adjust the scope of the process over time to ensure that it includes all major tax incentives.<sup>h</sup> That way, lawmakers will consistently receive the high-quality information on the results of tax incentives that DLS has shown it can provide.

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## Massachusetts



### Key points:

- Massachusetts is **trailing** other states because it has not adopted a plan for regular evaluation of tax incentives.
- The state produces high-quality evaluations of its film tax credit but does not analyze other major incentives.
- Several offices in Massachusetts could potentially evaluate incentives, including the Department of Revenue and the office of the inspector general.

High-quality evaluations of Massachusetts' film tax credit have helped spark robust debates over the cost-effectiveness of the program. However, the state lacks a process for evaluating other tax incentives.

The Massachusetts Department of Revenue has studied the film credit more than a half-dozen times over the last decade.<sup>a</sup> These studies make reasonable assumptions about the extent to which the credit is leading productions to locate in Massachusetts. They calculate the trade-offs of paying for the incentive, noting that a dollar the state spends on the credit cannot go to other purposes. They also estimate the extent to which the economic benefits from the program flow to other states, such as when film productions hire out-of-state workers.<sup>b</sup> By taking these considerations into account, Revenue has rigorously measured the economic impact of the program.

Revenue's analysis shows that the film tax credit has cost the state more than \$100,000 for each net new job the program has created for Massachusetts residents.<sup>c</sup> Based on the evaluations' findings, some policymakers have argued that the state would be better off investing in alternative economic development strategies. Both former Governor Deval Patrick (D) and current Governor Charlie Baker (R) have proposed scaling back the credit. The Legislature has discussed that idea, but has not acted on it.<sup>d</sup>

Given its experience rigorously studying the film credit, the Department of Revenue is one office that could potentially evaluate incentives regularly in Massachusetts. There are other options as well. A 2016 bill would have created a new unit in the office of the inspector general to evaluate tax incentives. It would also have set standards for new tax incentives, including that lawmakers define their goals—a step other states have found facilitates meaningful evaluation. The legislation passed the Senate but was not approved by the House.<sup>e</sup>

The inspector general and the state auditor are interested in providing policymakers with better information on outcomes from the millions spent on incentives each year. However, these offices say their efforts have been stymied because they lack access to data that would allow them to analyze incentives.<sup>f</sup>

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# Michigan



## Key points:

- Michigan is **trailing** other states because it has not adopted a plan for regular evaluation of tax incentives.
- The state has shifted its economic development strategy in recent years, but these decisions have not been adequately informed by analysis of the results of incentives.
- The Michigan Economic Growth Authority (MEGA) tax credit has caused budget challenges, highlighting the need for better information.

Michigan has shifted its economic development strategy in recent years, investing heavily in tax incentives at some points and scaling back at others. Because the state lacks an ongoing process for evaluating incentives, however, it made these shifts without adequate information about whether these programs were working or how they might be improved.

Michigan scaled up its suite of economic development tax incentive programs during its long, severe economic downturn, placing big bets on such industries as advanced battery manufacturing. Then in 2011, the state significantly scaled back its tax incentives, preferring to cut business taxes broadly and deploy grant-based programs.<sup>a</sup> In late 2015, though, the state reversed course, creating a new sales and use tax exemption for data centers designed to lure a Nevada-based company to make a potential \$5 billion investment in the state.<sup>b</sup>

As lawmakers have considered these changes, they have debated both the cost and effectiveness of the state's incentives. Budget challenges have been a particular area of concern. Even though the state's flagship MEGA tax credit program was closed to new participants in 2011 (along with many other tax incentives), the costs of the program are expected to continue until at least 2032 as a result of the state's pre-existing commitments.<sup>c</sup> In 2015, lawmakers had to close a midyear budget gap with spending cuts after it became clear that the incentives were going to be far more expensive than projected, throwing the budget out of balance by hundreds of millions of dollars.<sup>d</sup>

As the state continues to weigh its approach to economic development, lawmakers should consider building a stronger foundation for future decision-making by establishing a regular cycle for review. Evaluating cash and tax incentive programs together, as states such as Oklahoma are doing, would allow policymakers to compare the results of programs with similar goals across the state's economic development portfolio.<sup>e</sup> Without an ongoing process for evaluation, lawmakers will not have the information they need to understand whether incentives are successful and to identify opportunities for improvement.

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## Minnesota



### Key points:

- Minnesota is **leading** other states because it has a well-designed plan to regularly evaluate tax incentives, experience in producing quality evaluations that rigorously measure economic impact, and a process for informing policy choices.
- The state's criteria for the studies reflect best practices for tax incentive evaluation.
- Since Minnesota's law does not require that each incentive be evaluated on a specific cycle, it will be up to lawmakers to ensure that they receive regular information on all major programs.

**Year enacted:** 2015.<sup>a</sup>

**Who evaluates:** Office of the Legislative Auditor.

**Length of review cycle:** None specified.

The Minnesota Office of the Legislative Auditor (OLA) has a long history of producing detailed studies of government programs that offer thoughtful recommendations for improvements. Under a 2015 law, the OLA is now producing similarly in-depth studies of economic development incentives.<sup>b</sup>

OLA's first study was an examination of Minnesota's Research Tax Credit, which the office completed in early 2017. The office analyzed data on the economic impact of the credit, surveyed taxpayers who benefit from it, interviewed relevant business associations, and compared Minnesota's program to a sample of other states' research and development credits. Through this work, the OLA reported on both the effectiveness of the credit and how well the state is overseeing it.<sup>c</sup>

The research credit study followed a plan for incentive evaluations that was adopted by the Legislative Audit Commission, the panel of legislators that oversees the OLA, in January 2016. This plan helps ensure that the OLA's studies reflect best practices for incentive evaluation. For example, the evaluations estimate the degree to which incentives influence business decisions, a key step for rigorously measuring economic impact. They also describe whether protections are in place so that the incentives do not cause budget challenges.<sup>d</sup> That information should be valuable: Many states have faced budget problems after the costs of incentives increased quickly and unexpectedly.<sup>e</sup>

Minnesota's law also includes a unique approach for providing information on "exclusive incentives" that lawmakers create for specific companies or projects. In recent years, lawmakers have committed hundreds of millions of dollars for exclusive incentives for major Minnesota employers such as the Mayo Clinic, the Mall of America, and the Minnesota Vikings.<sup>f</sup> Under the law, the OLA is required to produce a report on best practices for exclusive incentives, to help guide the Legislature's decision-making on these kinds of deals in the future, rather than second-guessing decisions that have already been made.<sup>g</sup>

One weakness of Minnesota's approach is the lack of a specific cycle for review. Many states, such as Connecticut, Florida, Indiana, Maryland, Mississippi, North Dakota, and Rhode Island, require that all tax incentives be evaluated every three to six years, but Minnesota's law simply requires the Legislative Audit

Commission to choose at least one incentive to be studied each year.<sup>h</sup> For that reason, it will be up to legislators on the commission to ensure that all major tax incentives are evaluated reasonably frequently.

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## Mississippi



### Key points:

- Mississippi is **leading** other states because it has a well-designed plan to regularly evaluate tax incentives, experience in producing quality evaluations that rigorously measure economic impact, and a process for informing policy choices.
- The first evaluation under Mississippi's law reached valuable conclusions about the effectiveness of numerous incentives.
- The evaluation also included recommendations for improving future studies, such as adopting a rotating evaluation cycle to allow for more detailed analysis.

**Year enacted:** 2014.<sup>a</sup>

**Who evaluates:** University Research Center.

**Length of review cycle:** Four years.

Mississippi has become a leader in tax incentive evaluation as a result of bipartisan 2014 legislation that requires the University Research Center (URC), an office within Mississippi's higher education system, to evaluate the state's economic development incentives every four years.<sup>b</sup>

In the first evaluation under the law, published in January 2016, the URC's economists reached valuable conclusions about the effectiveness of numerous incentives using a mix of empirical analysis and common sense. For example, Mississippi has committed more than \$200 million in incentives for "cultural retail attractions," such as outlet malls, under the state's Tourism Rebate Program. The evaluation questioned the effectiveness of this economic development strategy, noting that many of the shoppers were likely to be Mississippi residents who would have spent much of their disposable income at other in-state retailers even if the new attractions were not built. The report concluded that focusing on projects that would draw a greater share of customers from out-of-state would have a larger impact.<sup>c</sup>

The authors also acknowledged the study's challenges and offered recommendations for how future evaluations could be improved. Faced with time constraints, the URC was not able to go into much depth on each program. In several instances, the URC was unable to measure the economic impact of incentives because of a lack of data. To address these challenges, the report recommended that state agencies such as the Mississippi Development Authority and Mississippi Department of Revenue work together to collect more information from incentive recipients and to develop consistent terminology for describing incentives.<sup>d</sup>

The URC also suggested that, rather than evaluating all incentives in a single report every four years, the center could study some programs in more depth each year.<sup>e</sup> Many states, such as Florida and Washington, have used this approach, developing rotating cycles for evaluation. This strategy does not just help evaluators produce more detailed studies of incentives, but it also helps lawmakers focus more closely on a subset of incentives each year.<sup>f</sup> If Mississippi adopted a rotating cycle, the evaluations might be more likely to lead to incentive improvements.

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# Missouri



## Key points:

- Missouri is **making progress** because the state has adopted a plan for regular evaluation of tax incentives.
- The state has made improvements to incentives as a result of evaluations from the state auditor.
- Missouri could advance further by ensuring that policymakers receive consistent information on the results of all major tax incentives.

**Year enacted:** 1999.<sup>a</sup>

**Who evaluates:** Office of the State Auditor.

**Length of review cycle:** Four years.

While many states are beginning to put in place systems to evaluate tax incentives, Missouri has had two such processes for years. The office of the state auditor regularly evaluates tax credits and other economic development programs, while the staff of the Legislature's Oversight Division studies credits that are approaching their expiration dates.<sup>b</sup> The analysis produced by these processes has helped the state improve the effectiveness of tax incentives. However, policymakers might benefit from receiving more consistent information on the results of the state's incentives.

The most thorough evaluations come from the auditor, an independently elected statewide official. The auditor's studies often include detailed analyses of whether state agencies are administering incentives efficiently. Some of the audits also include discussions of the economic impact of incentives, although other states, such as Indiana, produce more rigorous analyses.

The auditor's evaluations have led to changes designed to make incentives work better. For example, a 2014 study of an incentive that encourages redevelopment of environmentally contaminated sites identified several weaknesses in the way the Department of Economic Development (DED) was administering it. Under the program, DED has discretion to offer credits for up to 100 percent of the costs of environmental remediation as part of redeveloping the sites. The audit noted that offering to pay for 100 percent of qualifying costs provided little motivation for developers to keep their costs in check. The audit also found fault with DED's procedures for verifying the validity of project costs.<sup>c</sup>

In response, DED began offering credits worth 100 percent of costs only when developers had used a competitive bidding process to contract for remediation work. The agency also began ensuring that project costs were verified by an engineer, architect, or certified public accountant.<sup>d</sup>

The Oversight Division's reviews do not include detailed analyses of the effectiveness of incentives. Instead, they consist primarily of background information on credits, including the history of the program, how it operates, and usage statistics. Then, the division offers a recommendation on whether the program should continue.<sup>e</sup>

A strength of this process is a strong connection to policymaking. Legislators on the Committee on Legislative Research hold hearings to consider the staff reviews and then recommend whether the expiring credits should be

continued, modified, or allowed to expire.<sup>f</sup> In contrast, lawmakers lack a formalized process for considering the auditor’s evaluations—making it less likely the Legislature will act on the findings.

The Oversight Division and auditor evaluations also do not fit together neatly. The division studies credits that are expiring, but not all credits have sunset dates.<sup>g</sup> By law, the auditor is responsible for evaluating all tax credits and all DED programs at least once every four years, but instead the auditor has focused on studying many of the state’s largest incentives.<sup>h</sup> Closer coordination between the two processes could help ensure that policymakers receive consistent information on the results of all major tax incentives.

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# Montana



## Key points:

- Montana is **trailing** other states because it has not adopted a plan for regular evaluation of tax incentives.
- State officials publish some descriptive information on tax incentives, but do not measure the effectiveness of these programs.
- During the 2015 session, lawmakers considered a bill that would have placed expiration dates on numerous tax credits, an approach that could encourage regular review of the programs.

Although Montana lacks a regular evaluation process, some legislators and state officials have recognized that implementing one could prove valuable. During the 2015 session, lawmakers considered a bill that would have placed expiration dates on numerous tax credits and required a legislative committee to review credits and make recommendations before these sunset dates.<sup>a</sup>

This approach has succeeded elsewhere. In Oregon, where tax credit programs expire after six years unless lawmakers extend them, the Legislature's Joint Committee on Tax Credits studies incentives in-depth and makes recommendations to the full Legislature. Through this process, the state has modified credits to improve their effectiveness, allowed some to expire, and extended others.<sup>b</sup>

In Montana, the bill passed the Legislature but was vetoed by Governor Steve Bullock (D).<sup>c</sup> In his veto message, Bullock called the concept of tax credit review commendable but objected to the fact that the legislation applied to only some credits rather than applying sunsets consistently.<sup>d</sup>

For now, Montana is in the position of many other states: Officials publish some descriptive information on tax incentives but do not measure their effectiveness. For example, the Department of Revenue produces a report every two years that includes cost data on the state's tax credits, exemptions, and deductions.<sup>e</sup> Additionally, legislative staff publishes data on individual income tax credits, including how Montanans at different income levels are affected by these provisions.<sup>f</sup>

It would be valuable to include Montana's largest tax incentives in any evaluation process. For example, the state provides a preferential rate for newly drilled oil and gas wells, a provision that costs the state tens of millions of dollars a year.<sup>g</sup> An evaluation could help determine whether this policy is a cost-effective way to increase economic activity in Montana.

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## Nebraska



### Key points:

- Nebraska is **leading** other states because it has a well-designed plan to regularly evaluate tax incentives, experience in producing quality evaluations that rigorously measure economic impact, and a process for informing policy choices.
- The state's first evaluation under its 2015 law included valuable analysis of the state's largest incentive, including highlighting the program's lack of fiscal protections.
- Lawmakers on the Performance Audit Committee are working to continue to improve future evaluations.

**Year enacted:** 2015.<sup>a</sup>

**Who evaluates:** Legislative Audit Office.

**Length of review cycle:** Three years.

Nebraska lawmakers have begun discussing ideas for improving the Nebraska Advantage Act, the state's largest economic development tax incentive.<sup>b</sup> A November 2016 evaluation of the program from the state's Legislative Audit Office will help inform those deliberations.<sup>c</sup>

The evaluation was the first under a 2015 law that requires the office to evaluate Nebraska's tax incentives on a three-year cycle.<sup>d</sup> It showed how the Advantage Act is performing on 13 metrics that lawmakers had identified as being important.<sup>e</sup>

One strength of the evaluation was its analysis of the Advantage Act's long-term costs. The evaluation noted that the program could cost hundreds of millions of dollars in coming years and that it lacked protections to prevent the fiscal impact from increasing beyond the state's expectations.<sup>f</sup> In response, the Legislature's Performance Audit Committee recommended that lawmakers consider whether changes to the program are needed to ensure that it does not cause budget difficulties.<sup>g</sup>

The Performance Audit Committee also offered numerous recommendations on how the state could improve future evaluations, including by enhancing the data available to the audit office and by further clarifying both the goals of the Advantage Act and how to measure success. For example, while the evaluation included useful information on the impact of the program, the office did not have access to economic modeling software that could have allowed for additional economic analysis. The committee recommended that the audit office continue to work with another legislative office to include modeling in the evaluations. It suggested lawmakers may introduce legislation to help with the challenge if those efforts are not successful.<sup>h</sup>

Some of the states with the most rigorous evaluations, such as Indiana and Washington, have continually made improvements to their processes. With the Performance Audit Committee's recommendations, Nebraska is well-positioned to follow their examples.

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## Nevada



### Key points:

- Nevada is **trailing** other states because it has not adopted a plan for regular evaluation of tax incentives.
- In recent years, the state has approved hundreds of millions of dollars in incentives for car manufacturers, technology companies, and a new stadium.
- The state has recently increased the amount of data it compiles on incentives, which could serve as a building block for future evaluations.

Many states have struck supersize incentive deals with businesses in recent years, but few have been as big as Nevada's 2014 agreement with electric car manufacturer Tesla, which includes \$1.3 billion in tax incentives over 10 years.<sup>a</sup> For its part, the company agreed to locate a massive new electric battery factory—what may eventually be one of the largest buildings in the world—in rural Nevada.<sup>b</sup> The state has also authorized hundreds of millions of dollars in incentives to Faraday Future (another electric car maker), eBay, and a new stadium intended to lure the National Football League's Oakland Raiders to Las Vegas.<sup>c</sup>

Despite the state's growing incentive commitment, Nevada lacks a process to regularly evaluate them. In recent years, though, the state has increased the amount of data it compiles on incentives. For example, in a report published every two years, the Governor's Office of Economic Development assembles various performance indicators such as the number of jobs businesses receiving incentives have pledged to create and the size of their capital investments.<sup>d</sup> This type of information could serve as a building block for evaluations that draw conclusions about the effectiveness of incentive programs and recommend improvements.

While most evaluation laws across the country establish reviews of incentive programs, a Nevada process could also provide information on the company-specific agreements that are such a prominent part of Nevada's economic development portfolio. In Minnesota, a 2015 evaluation law requires quadrennial reports on best practices for deals tailored to specific companies or projects, including how best to structure performance standards and protections to ensure that those standards are met.<sup>e</sup> An approach like Minnesota's could provide Nevada lawmakers with valuable information for the next time a Tesla or Faraday Future comes along.

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## New Hampshire



### Key points:

- New Hampshire is **making progress** because the state has adopted a plan for regular evaluation of tax incentives.
- Without a clear role for professional staff, New Hampshire's law may not result in detailed analysis.
- Some of the state's largest incentives provide loans and loan guarantees, but these programs are not included in the evaluation process.

**Year enacted:** 2014.<sup>a</sup>

**Who evaluates:** Joint Committee on Tax Expenditure Review.

**Length of review cycle:** Five years.

Under a 2014 New Hampshire law, tax incentives will receive more scrutiny. The law created a panel of legislators called the Joint Committee on Tax Expenditure Review to study tax incentives on a five-year rotating cycle. Based on these reviews, the committee will recommend whether each incentive should be continued, modified, or repealed.<sup>b</sup>

One potential weakness of New Hampshire's law is that it lacks a clear role for professional staff. The work of similar committees in other states is usually informed by analysis of the results of incentives from auditors, economists, or other professionals. In contrast, New Hampshire's law envisions legislators themselves taking the lead role in drawing conclusions about incentives.

That strategy can work. North Dakota's 2015 evaluation law also places a legislative committee in charge of evaluating incentives.<sup>c</sup> Working with legislative and executive branch staff to gather information, North Dakota legislators studied incentives in detail in 2016, including uncovering what some lawmakers see as a serious flaw in one of the state's incentives.<sup>d</sup> But an approach that de-emphasizes staff evaluators puts the burden on the lawmakers to seek out information from state agencies and other stakeholders to carefully study incentives themselves. So far, New Hampshire's committee is off to a slow start. In 2016, the panel met only briefly and did not offer detailed recommendations.<sup>e</sup>

New Hampshire's process could also be broadened to cover more of the state's major incentives. The committee is responsible for studying only tax incentives, but some of New Hampshire's largest incentive programs are cash incentives—especially loans and loan guarantees. For example, in 2015, the Legislature expanded the credit limit of the New Hampshire Business Finance Authority to \$115 million.<sup>f</sup> That move was designed to allow the authority to issue \$28 million in bonds to help redevelop and reopen a resort in northern New Hampshire that closed in 2011.<sup>g</sup> Other states with large cash incentives, such as Oklahoma, have included them with tax incentives in evaluation processes.<sup>h</sup> That way, states can consider their full economic development portfolio and identify the most effective strategies.

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## New Jersey



### Key points:

- New Jersey is **trailing** other states because it has not adopted a plan for regular evaluation of tax incentives.
- The state has contracted with researchers from Rutgers, the state university of New Jersey, to complete a one-time study of incentives by 2018.
- New Jersey has made billions of dollars in incentive commitments in recent years.

Under a 2013 law, New Jersey is scheduled to complete a “comprehensive review and analysis” of incentives administered by the New Jersey Economic Development Authority (EDA), the state’s lead business development organization, by July 1, 2018. The law, however, requires only a one-time evaluation, not regular analysis.<sup>a</sup>

In 2016, the authority contracted with researchers from Rutgers’ Edward J. Bloustein School of Planning and Public Policy to complete the evaluation.<sup>b</sup> In doing so, New Jersey is following a proven model. Many states, including Tennessee, North Carolina, and Oregon, have received rigorous evaluations by contracting with private consultants or academic institutions.<sup>c</sup>

The law with the evaluation requirement also included a major overhaul of the state’s approach to economic development. The legislation consolidated several incentives into two primary programs, one focused on creating and retaining jobs and the other on real estate development. As lawmakers intended, this overhaul led to a massive increase in the value of incentives awarded to businesses.<sup>d</sup> The EDA has authorized around \$5 billion in grants and tax credits since the 2013 law was enacted, in many cases committing to provide incentives for 10 to 20 years.<sup>e</sup>

As these commitments have grown, New Jersey’s use of incentives has been the subject of intense debate. Critics, in addition to worrying that the costs will crowd out other priorities, have pointed out that many of the incentive deals are aimed at existing New Jersey firms that are moving within the state. They argue that these deals do little to boost net economic activity in the state.<sup>f</sup> On the other hand, EDA and other defenders of the incentives say that the companies they have helped were at risk of leaving the state. They also argue that the assistance is the only way to get major businesses to relocate to places like Camden, one of the most impoverished cities in the country.<sup>g</sup>

High-quality evaluations in other states have helped answer the questions that are most relevant for this debate, such as to what extent incentives influence business decisions as opposed to rewarding what companies would have done anyway, and how incentives are affecting net economic activity. If the Rutgers study includes the same level of scrutiny, it will provide valuable information for New Jersey lawmakers, while also representing a first step toward regular, rigorous evaluation.

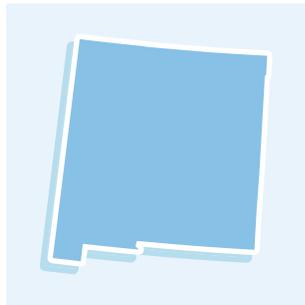
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## New Mexico



### Key points:

- New Mexico is **trailing** other states because it lacks a well-designed plan for regular evaluation of tax incentives.
- Under an executive order, the Taxation and Revenue Department studies tax credits, exemptions, and deductions, but the reports lack detailed economic analysis.
- Designing a process in which economic development tax incentives are evaluated on a rotating cycle would help New Mexico begin producing more rigorous information.

In 2011, Governor Susana Martinez (R) signed an executive order requiring the Taxation and Revenue Department to prepare an annual report on tax credits, exemptions, and deductions, including an evaluation of each program.<sup>a</sup> These reports include valuable descriptive information on tax incentives, including their purposes, how they function, and how much they cost. They also include policy recommendations for many incentives, some of which offer ways to improve the design of the programs. However, the evaluation of each program typically consists of only a few paragraphs of discussion, with little or no original economic analysis.<sup>b</sup>

Unlike most states that regularly evaluate incentives, New Mexico's studies are not required by statute. Consequently, it will be up to future administrations to continue the evaluations.

New Mexico lawmakers have several options to improve the process. The annual report includes analysis of more than 200 tax provisions.<sup>c</sup> This broad scope makes the report a useful resource for policymakers; many states have found that cataloguing all tax expenditures in a single report helps lawmakers understand tax policy choices. However, most states do not require evaluation of every tax expenditure. New Mexico policymakers could consider providing more scrutiny to major tax incentives, such as the High Wage Jobs Credit, which cost \$70 million in fiscal year 2015, than to such expenditures as a tax exemption totaling \$10,000 annually for street vendors with disabilities.<sup>d</sup>

For example, Nebraska's Department of Revenue publishes an annual report with descriptive information on more than 100 tax expenditures.<sup>e</sup> Separately, Nebraska's Legislative Audit Office evaluates the state's eight economic development tax incentives.<sup>f</sup> New Mexico could use a similar approach to produce a more in-depth analysis. Developing a rotating multiyear cycle for evaluation—a strategy used in Colorado, Nebraska, Oklahoma, and many other states—would also allow time for more detailed studies.

New Mexico could also consider tasking a different office with conducting the evaluations. For example, the nonpartisan staff of the Legislative Finance Committee previously produced valuable analysis of economic development tax incentives. A 2012 report from the committee found that the state lacked the information needed to determine whether its job creation incentives were achieving their goals.<sup>g</sup> New Mexico lawmakers could remedy that situation by designing an improved process to produce high-quality evaluations of tax incentives.

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## New York



### Key points:

- New York is **trailing** other states because it has not adopted a plan for regular evaluation of tax incentives.
- The state has produced several evaluations in recent years that have helped improve incentives, but other programs are not subject to the same scrutiny.
- High-quality evaluations could help inform ongoing debates over the merits of Start-Up NY and other incentive programs.

New York has produced several evaluations in recent years that have helped improve tax incentives. Without a consistent approach, however, lawmakers have struggled at times to determine which incentives are cost-effective.

The office of the New York comptroller, an elected official who serves as the state's chief fiscal officer, has published many of the evaluations. For example, the office regularly analyzes the state's industrial development agencies (IDAs)—local entities that provide hundreds of millions of dollars in tax exemptions to businesses each year. The office conducts an annual study of the IDA program as a whole and also frequently audits specific IDAs.<sup>a</sup> Based on this analysis, the comptroller supported legislation that lawmakers adopted in 2015 to reform the IDA program.<sup>b</sup> The legislation requires IDAs to use standardized criteria for selecting which businesses receive incentives as well as standardized agreements that document the terms of the deals.<sup>c</sup> Those changes are designed to ensure that only deserving businesses that fulfill their performance obligations receive incentives.<sup>d</sup>

Similarly, a 2013 evaluation that was conducted for a state commission noted weaknesses in New York's Brownfields Cleanup Program, one of the state's largest tax incentives. The program was created to encourage cleanup and development of environmentally contaminated sites, but the evaluation showed that the state had awarded credits to projects that had little to do with its environmental goals.<sup>e</sup> New York lawmakers revised the program in 2015 to more closely link the size of the awards to the amount of environmental remediation.<sup>f</sup>

In other instances, however, lawmakers have lacked this type of information. A case in point is the debate over a program called Start-Up NY. In 2013, Governor Andrew Cuomo (D) and New York lawmakers created this initiative with a bold promise: Businesses could operate tax-free for up to 10 years if they created jobs in designated zones on or near university campuses.<sup>g</sup> The concept of the program is for high-tech businesses to partner with universities—taking advantage of their research laboratories, for example—to help the companies grow.<sup>h</sup> By summer 2016, though, Start-Up NY was the subject of widespread criticism after the state reported that the program had created only a few hundred jobs.<sup>i</sup> In January 2017, Gov. Cuomo proposed a significant redesign of the program.<sup>j</sup>

A high-quality evaluation would identify metrics for measuring the program's performance, determine a reasonable time frame for assessing the results, and compare the incentive to policy alternatives.

The state's lead economic development agency, Empire State Development, is statutorily required to produce a one-time evaluation of Start-Up NY, but that report is not due until Dec. 31, 2020.<sup>k</sup> With a regular evaluation process, New York lawmakers would have timely, consistent information to assess the performance of all its tax incentives.

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## North Carolina



### Key points:

- North Carolina is **trailing** other states because it has not adopted a plan for regular evaluation of tax incentives.
- The state has produced high-quality one-time studies of some incentives.
- An evaluation process could provide information on the results of both tax incentives and the cash grants that have become a larger part of the state's economic development portfolio in recent years.

North Carolina has proved that it is capable of producing high-quality tax incentive evaluations; however, these have been one-time studies. The state lacks a regular process for measuring the results of its incentives.

In 2013, for example, the General Assembly's Fiscal Research Division studied the state's film tax credit at a legislator's request. The evaluation included a rigorous assessment of the program's economic impact. It used economic modeling to estimate to what extent film productions in North Carolina would have located elsewhere without the incentive. It also compared the results of the film tax credit to an alternative scenario in which the money had been used for a broad-based business tax cut and found that the tax cut would have led to better economic results.<sup>a</sup>

The evaluation was part of a yearslong debate over the merits of the program. Ultimately, lawmakers changed the film tax credit to a cash grant and scaled it back somewhat—though they still approved \$60 million for it in the two-year budget adopted in 2015.<sup>b</sup> The state has also allowed several other tax incentives to end in recent years, instead shifting the state's economic development portfolio toward cash incentives such as grants and loans.<sup>c</sup> For example, the Job Development Investment Grant, a cash program, is now one of the state's largest incentives.<sup>d</sup> This shift could be relevant if lawmakers look to design an evaluation process. Other states, such as Florida and Oklahoma, have designed processes to study both cash and tax incentives in order to have information on a broad range of economic development programs.<sup>e</sup>

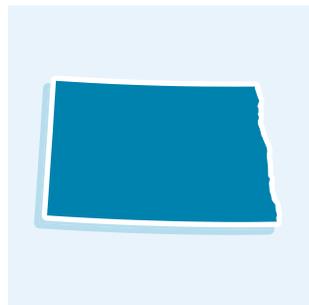
Evaluations would be valuable to help provide North Carolina lawmakers with timely information on their incentives. For example, for 20 years the state has divided counties into tiers to try to direct benefits—from incentives and other programs—to the most distressed areas of the state. A 2015 legislative staff study, however, found that the tier system was flawed and recommended eliminating it.<sup>f</sup> A regular evaluation process could help North Carolina identify that type of subtle defect in incentive programs, so that lawmakers could improve the effectiveness of the state's economic development efforts.

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## North Dakota



### Key points:

- North Dakota is **making progress** because the state has adopted a plan for regular evaluation of tax incentives.
- In the first round of evaluations, lawmakers uncovered a potentially serious flaw in the state's Angel Fund Investment Tax Credit.
- Lawmakers are studying ways to include rigorous economic analysis in future evaluations.

**Year enacted:** 2015.<sup>a</sup>

**Who evaluates:** Political Subdivision Taxation Committee.

**Length of review cycle:** Six years.

Tasked with systematically reviewing the state's tax incentives, the North Dakota Legislature's Political Subdivision Taxation Committee has studied more than a dozen incentives starting in summer 2015.<sup>b</sup> This work is poised to help North Dakota improve the effectiveness of its economic development initiatives.

The committee uncovered what lawmakers see as a potentially serious flaw in the state's Angel Fund Investment Tax Credit. The tax credit encourages investment in North Dakota angel funds, which were created to boost growth and entrepreneurship in the state by providing needed capital to local businesses with strong growth potential. However, lawmakers found out that the program rules have allowed these funds to invest in out-of-state companies, many of which have no economic impact in North Dakota.<sup>c</sup> Further, the committee's work was hampered by a lack of data and transparency, making it difficult to measure the program's results.<sup>d</sup>

Ultimately, the committee recommended ending the angel credit. The panel also made several other recommendations, including proposals to end some little-used incentives and to make technical changes to others.<sup>e</sup>

The committee's work is an early success for North Dakota's new incentive evaluation process, which requires legislators to play an active role. Under the state's 2015 evaluation law, the committee holds regular hearings between legislative sessions.<sup>f</sup> These hearings provide an opportunity for lawmakers to publicly discuss incentives up for evaluation and allow professional, nonpartisan staff to present background information necessary for a proper examination.<sup>g</sup> To guide this work, the law highlights specific topics committee members should consider such as whether an incentive has met its goals and to what extent it rewards behavior that would have occurred without the incentive.<sup>h</sup> This approach is well-suited to North Dakota, where legislative committees are used to taking the time required to tackle significant issues during the 20 or so months they are not in session out of every two years.

Despite the successes, lawmakers are still looking to improve North Dakota's evaluation process. Legislative staffers have extensive tax policy knowledge but do not have experience conducting sophisticated economic analyses. Committee members have recognized this gap and have discussed a proposal to give the Legislature access to economic modeling software to evaluate the impact of incentives.<sup>i</sup> Their hope is that the committee will have even more information with which to draw valuable conclusions about the effectiveness of incentives in the next round of evaluations.

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## Ohio



### Key points:

- Ohio is **making progress** because the state has adopted a plan for regular evaluation of tax incentives.
- The state recently established a legislative committee to study tax incentives, an approach that has worked well in other states.
- The committee could strengthen the process by requesting written evaluations from professional staff to inform its work.

**Year enacted:** 2016.<sup>a</sup>

**Who evaluates:** Tax Expenditure Review Committee.

**Length of review cycle:** Eight years.

In Ohio, regular evaluation of tax incentives has won broad support from across the political spectrum, with think tanks on both the left and right and some business groups backing the concept.<sup>b</sup> With that encouragement, Ohio lawmakers approved legislation in December 2016 that requires regular evaluation of all tax expenditures, including economic development tax incentives.<sup>c</sup>

The measure created the Tax Expenditure Review Committee, made up of six legislators with the state tax commissioner as a nonvoting member.<sup>d</sup> Other states have created new legislative committees as a way to study tax incentives in more depth. This approach has proved especially successful in Oregon.<sup>e</sup> The Ohio committee will be responsible for reviewing tax expenditures on an eight-year cycle and recommending whether each tax expenditure should be continued, modified, or ended.<sup>f</sup>

The law directs legislative staff to assist the committee but does not specify that the staff should provide evaluations.<sup>g</sup> Other states, such as Florida, Indiana, Maryland, and Washington, have laid out specific responsibilities for legislative staff to study the results of incentives and have received rigorous evaluations as a result. The Ohio committee could act to ensure that its work is informed by similar high-quality evaluations.

The size of some of Ohio's incentives is growing. Starting July 1, 2016, the state doubled the cap on its film tax credit from \$40 million a biennium to \$40 million a year.<sup>h</sup> The state's Job Creation Tax Credit cost \$80 million in fiscal year 2015, twice as much as forecast.<sup>i</sup> Evaluations should help Ohio determine whether these commitments are worth the price.

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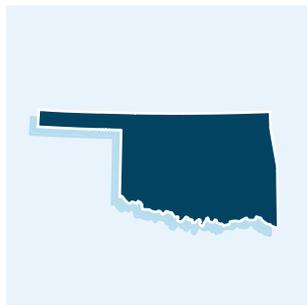
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## Oklahoma



### Key points:

- Oklahoma is **leading** other states because it has a well-designed plan to regularly evaluate tax incentives, experience in producing quality evaluations that rigorously measure economic impact, and a process for informing policy choices.
- By creating the Incentive Evaluation Commission, Oklahoma has ensured that a range of perspectives are represented in the review process.
- The first round of evaluations, published in 2016, included thoughtful analysis of 11 incentives that collectively cost \$110 million.

**Year enacted:** 2015.<sup>a</sup>

**Who evaluates:** Private consultants.

**Length of review cycle:** Four years.

For years, Oklahoma lawmakers have disagreed sharply on incentive policy. Some view incentives as an essential tool for attracting businesses while others regard the programs as wasteful government overreach.<sup>b</sup> In 2015, though, supporters and skeptics of incentives were able to agree on a key principle: The state needed better information. The result was legislation that requires evaluation of economic development incentives on a four-year rotating cycle.<sup>c</sup>

The law created the Incentive Evaluation Commission to oversee the process. The commission determines which incentives will be evaluated each year and identifies their goals and what criteria to use to determine their success. Then, the commission can contract with academic institutions or private consultants to analyze each incentive. Finally, the commission makes policy recommendations to lawmakers.<sup>d</sup>

A strength of the commission is the range of perspectives that are represented. The voting members are private citizens who are appointed by the governor, legislative leaders, and nongovernmental organizations such as the Oklahoma Economic Development Council. Three executive branch officials, including two who are responsible for administering incentives and one with general budget and policymaking responsibility, serve as nonvoting members.<sup>e</sup>

In the first year of evaluations, 2016, the commission selected 11 incentives for review that collectively cost \$110 million.<sup>f</sup> To study the programs, it hired a consulting firm using a request for proposal process.<sup>g</sup> This approach resulted in detailed evaluations with thoughtful discussions of each incentive.<sup>h</sup> One strength of the evaluations was their assessments of whether each incentive has adequate protections to ensure that its costs do not increase quickly and unexpectedly—a particularly relevant consideration for Oklahoma, which has faced budget challenges in recent years because of certain incentives.<sup>i</sup>

The evaluations also presented clear, well-supported policy options. In some cases they proposed wholesale overhauls of incentives, while in others they suggested more subtle changes, such as collecting better data.<sup>j</sup> Even if those recommendations do not end all disagreements over incentives, they should provide a common starting point for discussions of how Oklahoma can strengthen its economy most effectively.

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## Oregon



### Key points:

- Oregon is **making progress** because the state has adopted a plan for regular evaluation of tax incentives.
- The state’s reviews have led to sweeping changes to incentives, with some programs modified or allowed to expire.
- Oregon could improve by rigorously measuring the economic impact of incentives.

**Year enacted:** 2009.<sup>a</sup>

**Who evaluates:** Legislative Revenue Office.

**Length of review cycle:** Six years.

Perhaps no state has gone further than Oregon to integrate consideration of tax incentives into the budget and policymaking process. As a result, Oregon lawmakers have made sweeping changes to tax credits over the last six years.

Oregon’s process has evolved gradually.<sup>b</sup> Under a 2009 law, most Oregon tax credits—including economic development incentives—expire every six years unless lawmakers renew them.<sup>c</sup> These “sunsets” encourage legislators to review credits, since they must act or else they will end. The sunsets were staggered so that different groups of credits would expire every two years.<sup>d</sup> In each legislative session during which lawmakers considered expiring credits so far—2011, 2013, and 2015—the process has resulted in substantial changes, with credits extended, modified, or allowed to sunset.<sup>e</sup>

For example, in 2015, lawmakers reviewed two sizable tax credits for child care expenses, each of which had separate eligibility standards. The Legislature decided to consolidate the credits into one means-tested program, with greater benefits for lower-income taxpayers.<sup>f</sup> Likewise, in 2011, lawmakers revised a tax credit for renewable energy projects, such as wind and solar farms, which had grown far more expensive than anticipated. In addition to increasing the program’s effectiveness, the changes are saving Oregon hundreds of millions of dollars.<sup>g</sup>

Starting in 2011, the Legislature created the Joint Committee on Tax Credits, a panel made up of members of the House and Senate revenue committees. Similar committees in other states sometimes meet only once a year, but Oregon’s joint committee holds numerous hearings during the legislative session. The joint committee also works with other relevant committees, which offer recommendations on changes to credits. Through this process, Oregon reviews tax credits much the same way it reviews direct spending programs, whereas in other states tax incentives often receive far less scrutiny.<sup>h</sup>

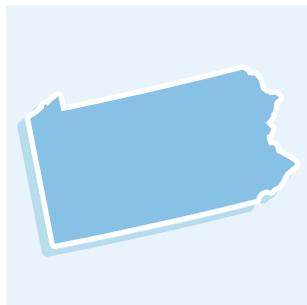
Initially, lawmakers lacked consistent information to consider these decisions, but a 2013 law has helped to change that. Under the law, the nonpartisan staff of the Legislative Revenue Office (LRO) studies credits before they are scheduled to expire.<sup>i</sup> The LRO’s first evaluation, published before the 2015 session, included detailed information on the history and rationale of each expiring credit. The LRO also described advantages and disadvantages of each credit and listed options for changes—an approach that allowed an office that does not traditionally make policy recommendations to nonetheless provide a starting point for lawmakers’ conversations.<sup>j</sup> The idea of consolidating the two child care credits was listed as an option in the LRO’s first report.<sup>k</sup>

While the LRO's 2015 evaluation included useful information, the study also noted the lack of data available on some credits.<sup>1</sup> The office has not been able to produce the rigorous economic analysis that has become a common feature of evaluations in other states, such as Indiana and Washington. If the LRO can begin measuring the economic impact of incentives effectively, lawmakers will have even more valuable information for the legislative discussions of tax credits that are sure to follow.

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# Pennsylvania



## Key points:

- Pennsylvania is **trailing** other states because it has not adopted a plan for regular evaluation of tax incentives.
- The auditor general, Legislative Budget and Finance Committee, and Independent Fiscal Office are potential candidates to regularly evaluate incentives should lawmakers create a process to do so.
- Economic development incentives cost Pennsylvania more than \$700 million a year.

Pennsylvania lacks a consistent process for studying economic development incentives, which cost the state more than \$700 million a year.<sup>a</sup> However, multiple offices within state government have experience in producing high-quality ad hoc evaluations of incentives.

For example, a 2013 report by the Legislature’s nonpartisan Independent Fiscal Office (IFO) rigorously analyzed the fiscal and economic implications of a proposal to remove the \$60 million-a-year cap from the state’s film tax credit.<sup>b</sup> One strength of the IFO’s analysis was that it compared the economic impact of increased spending on the credit to other ways the state could have spent the money.<sup>c</sup> Considering these “opportunity costs” is a key part of economic analysis. Since any use of state dollars will have some economic benefits, evaluations need to compare incentives to policy alternatives.

In addition, the professional staff of Pennsylvania’s Legislative Budget and Finance Committee published evaluations of Pennsylvania’s Keystone Opportunity Zone (KOZ) program and film credit in 2009, as well as a comprehensive report on the state’s tax credit programs in 2010.<sup>d</sup> The KOZ study found that the state lacked basic information on the results of the program, such as the types of businesses receiving incentives, their activities, and the number of jobs they created.<sup>e</sup> In 2012, Pennsylvania lawmakers required the Department of Community and Economic Development (DCED) to monitor the performance of KOZ participants in more detail to help address these issues.<sup>f</sup>

More recently, in 2014, the state’s auditor general studied grant and loan programs administered by DCED.<sup>g</sup> The audit stated that the department did not set any performance goals or measure the success of its job creation programs during the period reviewed by the auditors.<sup>h</sup> DCED also did not verify whether 46 businesses that were awarded \$16.9 million in loans actually created or retained jobs.<sup>i</sup>

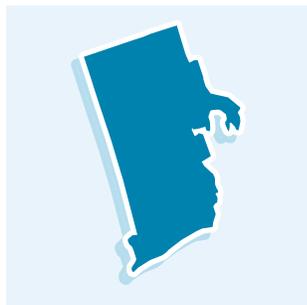
The auditor general, the Legislative Budget and Finance Committee, and the IFO are potential candidates to regularly evaluate incentives should lawmakers create a process to do so. Such a process would ensure that lawmakers have the information they need to improve the effectiveness of economic development programs on an ongoing basis.

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## Rhode Island



### Key points:

- Rhode Island is **making progress** because the state has adopted a plan for regular evaluation of tax incentives.
- The Office of Revenue Analysis (ORA) has faced challenges implementing the evaluations but recently produced high-quality analysis.
- Lawmakers could potentially modify the process to help make the ORA's job easier by modifying the review schedule or streamlining the requirements for each evaluation.

**Year enacted:** 2013.<sup>a</sup>

**Who evaluates:** Office of Revenue Analysis.

**Length of review cycle:** Three years.

Rhode Island enacted a law requiring regular evaluation of tax incentives in 2013 but has struggled to implement the process so far. Under the law, the state Office of Revenue Analysis (ORA), a unit in the executive branch that studies the state's budget and economy, is tasked with evaluating each economic development tax incentive on a three-year cycle.<sup>b</sup> The ORA has faced challenges recruiting and retaining staff, making it difficult for the office to meet all of its statutory requirements.<sup>c</sup>

To help address this issue, the state budget that Governor Gina Raimondo (D) signed in June 2016 provides funding for two additional ORA staffers.<sup>d</sup> This funding boost appears to be helping. While the ORA has not published any evaluations under the 2013 law, the office produced analysis of some incentives in October 2016 to fulfill a separate statutory requirement.<sup>e</sup> This report included high-quality information on the economic impact of the incentives. It analyzed different scenarios for the extent to which the incentives changed business behavior and compared the programs' economic outcomes to potential alternative uses of state funds.<sup>f</sup>

There are options to modify Rhode Island's process in order to ensure the ORA can produce similarly high-quality information regularly for all major tax incentives. First, under the 2013 law, each evaluation is required to include 12 components, some of which may be unnecessary, overly specific, or duplicative of information that is reported elsewhere.<sup>g</sup> Streamlining the requirements could make it easier for the ORA to begin producing evaluations, while also keeping the studies focused on the most important information: the results of incentives for the state's budget and economy and how their effectiveness can be improved.

Another option would be to modify the review schedule. Most states with evaluation processes that focus specifically on tax incentives, such as Rhode Island's, study each incentive every three to five years.<sup>h</sup> Switching to a four- or five-year cycle could lessen the ORA's burden while still providing lawmakers with regular information on the results of each incentive.

Rhode Island's 2013 evaluation law was part of a multifaceted response to an economic development disaster. In 2010, the state made a \$75 million loan guarantee to a startup video game company known as 38 Studios that was founded by former Major League Baseball player Curt Schilling. By 2012, 38 Studios had collapsed—leaving the state to pay the bill to bondholders.<sup>i</sup> After the 38 Studios debacle, the state briefly scaled back its use of

incentives but has recently expanded them again.<sup>j</sup> Only with high-quality evaluations will state officials know for sure whether this strategy is working.

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## South Carolina



### Key points:

- South Carolina is **trailing** other states because it has not adopted a plan for regular evaluation of tax incentives.
- As of fiscal 2015, economic development incentives cost South Carolina \$433 million.
- The state's Revenue and Fiscal Affairs Office had begun to publish reports on incentives every two years, though it has not yet analyzed the effectiveness of the programs.

Incentives have been central to South Carolina's economic strategy since the state used a \$130 million incentive package to help lure a BMW manufacturing plant to the state 25 years ago.<sup>a</sup> In the fiscal year ending June 30, 2015, the most recent year for which data is available, economic development incentives cost the state \$433 million.<sup>b</sup> Despite the size of that commitment, South Carolina lacks a process to regularly evaluate these programs.

In recent years, though, researchers in the executive branch have begun to fill in this information gap. In 2016, the Revenue and Fiscal Affairs Office published a report that included an inventory of the state's incentives, along with analysis of usage trends for the programs.<sup>c</sup> The report did not assess the effectiveness of incentives, however. The office is planning to update the research every two years, with the next report scheduled to be published in 2018.<sup>d</sup>

Since the BMW deal, South Carolina has used incentives to try to attract other major manufacturers. Under a 2009 agreement, the state is providing hundreds of millions of dollars in incentives to Boeing, which is assembling 787 Dreamliners in the state.<sup>e</sup> South Carolina also landed Volvo's first American manufacturing plant in 2015.<sup>f</sup> Retailers—rather than manufacturers—have prompted some of the most heated debates over incentives in the state Legislature. In 2011, lawmakers struck a deal with Amazon to build a distribution center in the state in exchange for a temporary sales tax exemption.<sup>g</sup> More recently, Bass Pro Shops announced plans for a new store in North Charleston with the expectation of receiving tax incentives the state offers for “extraordinary retailers.”<sup>h</sup> In both cases, competing retailers have argued that these deals put them at a disadvantage.<sup>i</sup>

Other states have objective information on whether those types of concerns are warranted. In Florida and Mississippi, high-quality evaluations have examined the extent to which incentives boost the economy overall, as opposed to helping some businesses at the expense of others.<sup>j</sup> With regular, rigorous evaluations, lawmakers in South Carolina would possess similar information, which they could use to improve the effectiveness of the state's incentives.

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## South Dakota



### Key points:

- South Dakota is **trailing** other states because it has not adopted a plan for regular evaluation of tax incentives.
- Evaluations would help legislators make decisions about incentives such as determining funding for the Building South Dakota program.
- The state relies more on grants and loans than tax incentives, so an evaluation process could include analyzing the results of these cash programs.

In 2013, South Dakota created a suite of economic development and housing programs—including tax incentives, grants, and loans—collectively known as Building South Dakota. A year later, lawmakers committed \$30 million to these programs through 2016.<sup>a</sup> With those three years of funding ending, policymakers began in late 2016 to discuss how much money should be committed to Building South Dakota going forward.<sup>b</sup>

While state agencies are required to report some information on Building South Dakota’s programs, the initiative has not been formally evaluated. Nor does South Dakota have a regular evaluation process in place. As a result, lawmakers are forced to make decisions about incentives without high-quality analysis of how well the programs are working.

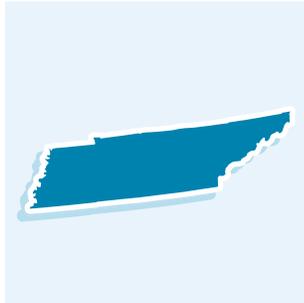
Tax incentives are a less significant part of South Dakota’s economic development portfolio than for other states. Instead, South Dakota has relied more heavily on grants and loans. One of the state’s largest incentives is the Revolving Economic Development and Initiative (REDI) Fund, which offers low-interest loans to businesses and local economic development organizations. In 2015, South Dakota provided \$20 million in loans from the REDI Fund.<sup>c</sup> Likewise, South Dakota’s most conspicuous economic development setback in recent years—the 2013 bankruptcy of a \$115 million beef processing plant only months after it opened—involved cash incentives, rather than tax incentives.<sup>d</sup> (The plant later reopened under new owners.)

Given South Dakota’s emphasis on cash incentives, lawmakers could follow the example of other states, such as Florida, Minnesota, and Oklahoma.<sup>e</sup> Those states evaluate tax and cash incentives alike, an approach that ensures that policymakers have information on the results of the full range of state economic development programs.

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# Tennessee



## Key points:

- Tennessee is **making progress** because the state has adopted a plan for regular evaluation of tax incentives.
- The state's first evaluation under the law, published in December 2016, includes rigorous economic analysis.
- One weakness of Tennessee's law is that it lacks a strong connection between the evaluations and the policymaking process.

**Year enacted:** 2015.<sup>a</sup>

**Who evaluates:** Private consultants.

**Length of review cycle:** Four years.

In 2015, Tennessee approved legislation requiring evaluation of the state's major economic tax credits every four years.<sup>b</sup> For the first study under the law, the state contracted with a consulting firm with experience evaluating incentives. The consultants' evaluation, published in December 2016, included recommendations for improving incentive programs such as a \$50 million job creation credit and a \$60 million credit to encourage businesses to upgrade machinery.<sup>c</sup>

In the study, the consultants analyzed the extent to which the tax credits are influencing business decisions, as opposed to rewarding what companies would have done anyway.<sup>d</sup> That type of analysis is a key step for rigorously measuring the economic impact of incentives.

One weakness of Tennessee's law is that it lacks a strong connection between the evaluations and the policymaking process. The law mandates that the report be delivered to the governor and key lawmakers but lacks a mandate for regular legislative hearings.<sup>e</sup> To ensure that evaluation results can be translated into policy, Tennessee can follow the example of other states. In Florida, for example, legislative committees have held frequent hearings on evaluations to discuss the findings and consider what program changes are necessary even without a statutory mandate to do so.<sup>f</sup>

Tennessee adopted the evaluation law as part of a significant shift in its approach to economic development. In 2015, the state eliminated many of its business tax credits.<sup>g</sup> That move coincided with the expansion of the state's FastTrack Grant Program, which costs close to \$100 million a year.<sup>h</sup> Given the significant role that FastTrack and other grants play in the state's economic development portfolio, analyzing these cash incentives in future evaluations could help ensure that lawmakers possess comprehensive information on the results of the state's incentives.

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# Texas



## Key points:

- Texas is **making progress** because the state has adopted a plan for regular evaluation of tax incentives.
- Texas' law does not specify how frequently each incentive program must be evaluated, but the board tasked with the evaluations could adopt a schedule that ensures lawmakers have timely information.
- Texas could strengthen its process by creating a role for professional staff to formally study incentives.

**Year enacted:** 2015.<sup>a</sup>

**Who evaluates:** Economic Incentive Oversight Board.

**Length of review cycle:** None specified in law.

In 2015, Texas legislation created a commission known as the Economic Incentive Oversight Board to regularly evaluate incentives. The bill also revamped several of the state's largest incentives amid concerns about the criteria state officials were using to determine which companies benefitted from the programs.<sup>b</sup> In creating the board, lawmakers acknowledged that they wanted more than just a one-time reboot of their incentives. Instead, the board has the potential to offer valuable information on these programs on an ongoing basis.

The board is made up of members of the public who are appointed by various state officials: the governor, the lieutenant governor, the speaker of the House, and the state comptroller. After studying incentives, the board is responsible for publishing a report every two years with policy recommendations on each incentive that it has reviewed.<sup>c</sup> After delays filling some of the positions on the board, it held its first meeting in December 2016.<sup>d</sup>

As the board ramps up its work, Texas could learn from the experiences of Washington and Oklahoma. Both states also have created citizens' commissions to help evaluate incentives. The commissions receive formal evaluations from skilled professionals: the nonpartisan staff of the Joint Legislative Audit and Review Committee in Washington and a private consulting firm in Oklahoma.<sup>e</sup> As a result, the commissions in these two states have the data and analysis they need to make informed policy recommendations.

Texas could strengthen its process by creating a similar role for professional staff or outside experts. While the Texas governor's office will provide assistance to the board, the law does not require staff to formally evaluate the programs.<sup>f</sup> Several offices, including the Legislative Budget Board, the Texas Sunset Advisory Commission, and the comptroller's office, have the skill set to potentially produce high-quality evaluations.

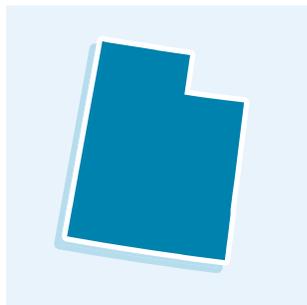
Several of Texas' largest incentives—such as the Texas Enterprise Fund—are cash grants rather than tax incentives.<sup>g</sup> For that reason, a strength of the law is that the board will review both cash incentives and tax incentives alike. In another way, however, the law's scope is narrower than in many other states. The board is only required to study incentives for which a state agency has the discretion to determine which businesses qualify on a case-by-case basis.<sup>h</sup> As a result, the board may not be required to review major incentive programs that are available to all businesses that meet predetermined eligibility criteria, such as the state's Research and Development Tax Credit.<sup>i</sup>

Unlike the laws in many other states, Texas' law also does not specify how frequently each incentive program must be evaluated. Instead, the board has discretion to set the review schedule.<sup>j</sup> In many states—including Florida, Mississippi, Oklahoma and Tennessee—all major incentives are reviewed at least once every three to five years.<sup>k</sup> By adopting a similar schedule, the Texas board could ensure that lawmakers have reasonably up-to-date information to guide policy decisions on each tax incentive.

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## Utah



### Key points:

- Utah is **making progress** because the state has adopted a plan for regular evaluation of tax incentives.
- A legislative interim committee will consider the evaluations and then make recommendations on whether each incentive should be continued, modified, or ended.
- Currently, the process requires evaluation of corporate and income tax credits, but the legislative fiscal analyst has recommended studying other incentives as well.

**Year enacted:** 2016.<sup>a</sup>

**Who evaluates:** Office of the Legislative Fiscal Analyst and the Governor's Office of Economic Development.

**Length of review cycle:** Three years.

In 2016, Utah lawmakers approved legislation requiring evaluation of tax credits on a three-year cycle. The law places the Revenue and Taxation Interim Committee in charge of the evaluation process. The committee, which convenes each year after the Legislature's regular session concludes, is responsible for recommending whether each credit should be continued, modified, or ended.<sup>b</sup> This approach appears well-designed to help lawmakers improve incentive policy once the evaluations begin in 2017; in Utah, interim committees often vet legislation that will be considered in the following session.<sup>c</sup>

The law builds on work that Utah is already doing: Various interim committees regularly discuss incentives and hear from agencies that administer them.<sup>d</sup> What makes the new law different is that the reviews will be informed by independent evaluations from the nonpartisan staff in the Office of the Legislative Fiscal Analyst (LFA). Additionally, the Governor's Office of Economic Development (GOED), which administers many incentives, will provide analysis to the committee.<sup>e</sup>

The law requires evaluation of corporate and income tax credits.<sup>f</sup> However, with the Legislature's blessing, the LFA has created an inventory of all state tax expenditures, including incentives that reduce sales and property taxes.<sup>g</sup> In October 2016, the LFA recommended expanding the scope of the review process to include these additional tax incentives. It also recommended adding purpose statements to incentives to provide a basis for assessing their success.<sup>h</sup>

In Utah, evaluation is already a proven approach for improving incentives. The state auditor published a 2014 evaluation that highlighted ways to improve the administration of one of the state's large incentives, the Economic Development Tax Increment Financing (EDTIF) program. The audit argued that GOED had incorrectly calculated wages in ways that allowed companies to qualify for incentives that they otherwise would not have.<sup>i</sup> The next year, lawmakers approved legislation clarifying how wages should be calculated to end several of the practices the audit had identified.<sup>j</sup>

The EDTIF audit, however, was only a one-time report. With the new law and the legislative fiscal analyst's efforts, Utah lawmakers will soon have regularly updated information on the results of their tax incentives.

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## Vermont



### Key points:

- Vermont is **trailing** other states because it has not adopted a plan for regular evaluation of tax incentives.
- The state has worked to clarify the goals of incentives, a key preliminary step for evaluating them.
- Lawmakers have requested and received detailed information from legislative staff on options for implementing an evaluation process.

Over the last several years, Vermont has taken a series of preliminary steps on the path to creating a process for regular evaluation of tax incentives. Now, policymakers are considering the best approach to put such a process in place.

In many states, including Vermont, policymakers have often created tax incentives without defining the programs' goals. Without clear statements of purpose, it is hard for officials to later determine when incentives have succeeded. To address this issue, Vermont passed a law in 2013 requiring the staff of the Legislative Joint Fiscal Office (JFO) to draft goals for each of the state's tax expenditures, including tax incentives and other types of tax credits, exemptions, and deductions.<sup>a</sup> The following year, lawmakers used the JFO's report to adopt in statute goals for each tax expenditure.<sup>b</sup>

These purpose statements proved valuable when lawmakers set the JFO on its next task in 2015: to design a process for regular evaluation of tax expenditures.<sup>c</sup> The JFO determined that not every tax expenditure needs the same level of review.<sup>d</sup> Economic development tax incentives are designed to change business behavior, so analyzing them generally requires quantitative research to determine whether they are successful in doing so. In contrast, some other tax expenditures are designed to provide targeted assistance to people or activities—Vermont exempts some military pay from its income tax and purchases of medical products from its sales tax, for example—rather than changing behavior. Reviews of these types of tax expenditures typically focus more on reconsidering whether the goals of the programs are still relevant than on quantitative analysis.

With these distinctions in mind, the JFO proposed that some tax expenditures receive “full evaluations,” others receive “expedited reviews,” and ones that cost very little or are very unlikely to change be exempt from review.<sup>e</sup> The JFO also laid out a potential evaluation schedule.<sup>f</sup> In 2016, lawmakers approved a bill requiring the JFO and the Department of Taxes to begin conducting expedited reviews.<sup>g</sup> However, a sticking point on the full evaluations remained: who would conduct the analysis. JFO's report suggested three options—the state auditor, the Department of Taxes, or the JFO itself—but lawmakers requested additional information on the staffing and funding required.<sup>h</sup>

The JFO's latest report, published in January 2017, offered a range of estimates for the funding required to establish an evaluation process. The estimates varied depending on how many tax expenditures would receive full evaluations each year.<sup>i</sup> The next step is for Vermont lawmakers to consider the options and determine the best way to design an evaluation process that is consistent with the state's own needs and resources.

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## Virginia



### Key points:

- Virginia is **making progress** because the state has adopted a plan for regular evaluation of tax incentives.
- In previous studies, the staff of the Joint Legislative Audit and Review Commission has demonstrated the capacity to conduct high-quality analysis of the performance of incentive programs.
- The first evaluations under Virginia's new process, scheduled for publication in 2017, will examine incentives for the film industry.

**Year enacted:** 2016.<sup>a</sup>

**Who evaluates:** Joint Legislative Audit and Review Commission.

**Length of review cycle:** Six to eight years, to be determined.

Virginia made a major commitment to regular, rigorous evaluation of its economic development incentives with the passage of its 2016-18 biennial budget. The budget requires the professional staff of the state's Joint Legislative Audit and Review Commission (JLARC) to regularly study the results of the state's economic development portfolio—including both tax incentives and cash grants and loans, which will help facilitate comparisons among programs with similar goals.<sup>b</sup>

JLARC has demonstrated the capacity to conduct high-quality analysis of the performance of incentive programs, including a January 2012 assessment of the effectiveness of tax preferences, a November 2012 assessment of grant programs, and a 2016 review of the Virginia Economic Development Partnership's operations.<sup>c</sup> Directing a legislative audit office to evaluate incentives is an approach that has been successful in other states. For example, Washington's legislative auditor has produced detailed evaluations of the state's incentives for a decade.<sup>d</sup> As a further boost to its expertise, JLARC plans to contract with an academic institution or private firm to assist with economic impact analyses.<sup>e</sup>

The budget legislation left the review schedule and other key details up to the legislators who serve on the commission that oversees the work of JLARC's professional staff.<sup>f</sup> In late 2016, they identified 76 incentives that JLARC will ultimately study on a six- to eight-year cycle. Three tax incentives for the film industry are up for review first, with the evaluation scheduled for completion in fall 2017.<sup>g</sup>

The commission includes key members of the House Appropriations and Senate Finance committees and the state auditor of public accounts, who serves as an ex officio, nonvoting member.<sup>h</sup> The success of the process will depend on the ability of commissioners to translate evaluation recommendations into policy action. And because many of them serve dual roles on committees with leadership responsibility for fiscal policy, they will be well-positioned to ensure that any recommendations receive a full airing in the Legislature.

As JLARC moves forward with implementation, it will need to coordinate with a separate legislative panel, the Joint Subcommittee to Evaluate Tax Preferences. Lawmakers created the subcommittee in 2012 to review the full range of tax credits, exemptions, and deductions.<sup>i</sup> To date, the subcommittee has not focused primarily on economic development incentives, but the work of the two bodies could eventually overlap.<sup>j</sup>

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## Washington



### Key points:

- Washington is **leading** other states because it has a well-designed plan to regularly evaluate tax incentives, experience in producing quality evaluations that rigorously measure economic impact, and a process for informing policy choices.
- The Joint Legislative Audit and Review Committee has long provided valuable insights on the history, purpose, and design of incentives.
- After an evaluation showed two tax incentives designed to encourage research and development spending were producing few jobs relative to their cost, lawmakers allowed the programs to expire, saving tens of millions of dollars.

**Year enacted:** 2006.<sup>a</sup>

**Who evaluates:** Joint Legislative Audit and Review Committee.

**Length of review cycle:** Ten years.

Washington has one of the nation’s longest-standing and most successful tax incentive evaluation processes. These evaluations have helped lawmakers improve incentive policy.

For example, a 2012 evaluation showed that two tax incentives designed to encourage research and development spending were producing few jobs relative to their cost.<sup>b</sup> Based on that finding, a citizen commission that oversees Washington’s evaluations recommended that policymakers allow the programs to expire.<sup>c</sup> Lawmakers followed that advice, saving the state tens of millions of dollars.<sup>d</sup>

Under a 2006 law, the nonpartisan staff of Washington’s Joint Legislative Audit and Review Committee (JLARC) is responsible for evaluating tax preferences—including credits, exemptions, and deductions—on a 10-year cycle. The citizen commission guides this work by determining which tax preferences should be evaluated and when. JLARC’s evaluations include recommendations to continue, modify, or end each incentive, and then the commission also offers its own recommendations. To connect this work to the policymaking process, the Legislature’s fiscal committees hold a joint hearing on the evaluations.<sup>e</sup>

From the beginning, JLARC has provided valuable insights on the history, purpose, and design of incentives. In recent years, the evaluations have succeeded in rigorously measuring economic impact. For example, a 2016 evaluation of an incentive for data centers used economic modeling to compare the results of the incentive to an alternative scenario in which the state had used the money to increase government spending instead.<sup>f</sup> Likewise, a 2015 film incentive evaluation showed what proportion of films would need to have located in Washington as a result of the incentive for the program to get better economic results than alternative strategies.<sup>g</sup>

In addition to changing specific incentives, Washington’s evaluation process has also helped reshape how the Legislature considers new tax preferences. As a result of 2013 legislation, any new tax preference must include a “performance statement.” Each statement documents the purpose of the tax incentive, how the state will know whether the program accomplished its goal, and what data evaluators will need to conduct the review.<sup>h</sup> In addition to helping JLARC produce high-quality analyses, the performance statements have also encouraged

lawmakers and advocates for incentives to think carefully about the design of proposed preferences and what they are trying to achieve.<sup>i</sup>

JLARC has produced high-quality analysis despite the sizable task it has faced: The committee staff has studied more than 200 tax preferences over the last decade. In 2016, the commission exempted from evaluation dozens of tax preferences that lawmakers deemed were consistent with basic principles of tax policy, such as avoiding double taxation.<sup>j</sup> As a result, as it begins its second decade of evaluations, JLARC will be able to focus in even more depth on the state's most important tax preferences.

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## West Virginia



### Key points:

- West Virginia is **trailing** other states because it has not adopted a plan for regular evaluation of tax incentives.
- West Virginia's State Tax Department evaluates four specific tax incentives once every three years, but others are not studied.
- The state does not evaluate a \$24.5 million-a-year property tax break that is designed to encourage manufacturers to expand their facilities.

By law, West Virginia's State Tax Department evaluates four specific tax incentives every three years.<sup>a</sup> These studies do not include all of the state's tax incentives but could serve as a starting point to a broader evaluation process.

The Tax Department's evaluations provide data on the cost of the incentives as well as the number of new jobs at participating businesses. The department also compares the rate of employment growth at businesses in incentive programs to industrywide trends.<sup>b</sup> Those comparisons hint at a key consideration for measuring the economic impact of incentives: whether they are causing businesses to create jobs or make investments that go beyond what they would have done without the assistance. The evaluations do not use that data to draw conclusions about the effectiveness of the incentives, however; the Tax Department lacks a clear legislative mandate for that type of more rigorous analysis.<sup>c</sup> The studies also do not include recommendations on how the programs can be improved.

In recent years, West Virginia has eliminated some tax incentives as part of an effort to simplify the tax code while lowering tax rates.<sup>d</sup> Still, the state has some major incentives that are not part of the evaluation process, such as a \$24.5 million-a-year property tax break that is designed to encourage manufacturers to expand their facilities.<sup>e</sup>

Unlike many other states, such as Maine, Oklahoma, and Washington, West Virginia does not require that new tax incentives be evaluated.<sup>f</sup> For example, 2012 legislation created incentives for chemical plants that could potentially cost hundreds of millions of dollars if an eligible facility locates in West Virginia.<sup>g</sup> By adopting a systematic evaluation process that includes any new incentives lawmakers enact, West Virginia could begin to produce high-quality information on the results of all of the state's incentives.

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## Wisconsin



### Key points:

- Wisconsin is **making progress** because the state has adopted a plan for regular evaluation of tax incentives.
- The evaluations have documented shortcomings in the management of incentives and, in response, officials have acted to make improvements.
- The state could improve by including rigorous economic analysis in the evaluations.

**Year enacted:** 2011.<sup>a</sup>

**Who evaluates:** Legislative Audit Bureau.

**Length of review cycle:** Two years.

In 2011, Wisconsin made a fundamental change to the state's approach to economic development. In place of the Wisconsin Department of Commerce, the state created the Wisconsin Economic Development Corp. (WEDC), a nonprofit managed by a board of state appointees, to administer most of the state's primary incentive programs.<sup>b</sup> Under a 2011 law, the Wisconsin Legislative Audit Bureau (LAB) is required to regularly evaluate WEDC-administered programs.<sup>c</sup> Annual audits from 2012 to 2015 found substantial shortcomings in WEDC's operations and its management of incentive programs.<sup>d</sup>

For example, the 2015 audit found that WEDC was administering incentives based on program policies that were in place at the time it initially struck deals with businesses, rather than the policies in place when the incentives contracts were executed. Since many months sometimes pass between the initial deal and contract execution, LAB argued that WEDC was operating the programs in ways that were inconsistent with current state law or policy.<sup>e</sup>

These evaluations are making a difference. In some instances WEDC has disagreed with LAB's findings, but WEDC also reports that it is acting to implement many of LAB's recommendations. For example, WEDC reported to lawmakers that as of July 1, 2016, it had shifted to administering incentives based on the policies in place at their execution date.<sup>f</sup>

To become a leader, Wisconsin may need to redesign this effort to yield robust measures of economic impact. Like most state audit offices, LAB has far more experience studying whether government programs are being administered efficiently than measuring economic impact. As a result, it is not surprising that, while the audits have produced dozens of recommendations for improving the administration of incentives, they have included comparatively little information on the economic and fiscal results of the programs. Wisconsin policymakers could follow the example of Washington, where the legislative auditor's office has been tasked with evaluating incentives for a decade.<sup>g</sup> Staff have gradually built up expertise in measuring economic impact and are now producing rigorous analyses.

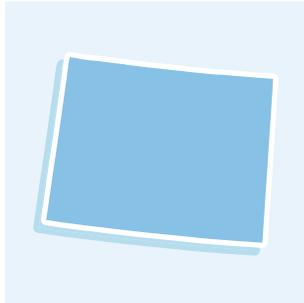
Wisconsin could also improve the scope of its review of economic development programs. While WEDC administers many of Wisconsin's major incentives, some, such as the \$36 million Research Expenditures Credit, are the responsibility of other agencies.<sup>h</sup> Broadening the Legislative Audit Bureau's mandate to include studies

of these programs would help ensure that lawmakers have comprehensive information on the results of the state's incentives.

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# Wyoming



## Key points:

- Wyoming is **trailing** other states because it has not adopted a plan for regular evaluation of tax incentives.
- State officials study specific tax exemptions annually and included economic modeling in the 2016 versions of these reports.
- Wyoming would need to adopt a broader process that includes other tax incentives and grant and loan programs to provide lawmakers with comprehensive information on the state's economic development portfolio.

Although Wyoming does not regularly evaluate all of its incentives, a state law mandates that the Department of Revenue, the Business Council, and the Department of Workforce Services jointly report on specific exemptions on an annual basis.<sup>a</sup>

Historically, the resulting reports are fairly limited in scope. The 2015 report on Wyoming's sales and use tax exemption for manufacturing machinery, for example, focused primarily on an analysis of the competitiveness of the manufacturing industry holistically, rather than on the effects of the incentive specifically.<sup>b</sup>

Recently, Wyoming has made efforts to improve the quality of the reports through a collaborative, multiagency process. Specifically, Wyoming's Economic Analysis Division—an office within the Department of Administration and Information—was invited in 2016 to join the other three agencies responsible for conducting the annual reports.<sup>c</sup> The Economic Analysis Division used economic modeling to study the impact of Wyoming's exemptions in the evaluations published in late 2016.<sup>d</sup>

To continue to improve, future evaluations could perform more rigorous economic analysis. For example, high-quality evaluations often use modeling to compare the effectiveness of alternative economic development strategies, but this type of analysis was not included in the 2016 studies.

Wyoming's review process could also be broadened to include more of the state's incentives. For example, it could consider evaluating programs such as the Small Business Investment Credit Program, an incentive that is designed to encourage more venture capital financing in Wyoming and could ultimately cost as much as \$30 million.<sup>e</sup>

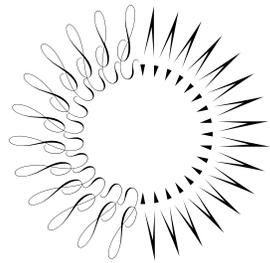
Because Wyoming relies heavily on cash incentives, it would be worthwhile for the state to study the effectiveness of its major grant and loan programs.<sup>f</sup> The program evaluation staff of the Wyoming Legislative Service Office in December 2016 published a detailed one-time study of the Business Ready Community Program, which has received \$390 million in funding since 2003, but other programs have not received similar scrutiny.<sup>g</sup>

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